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Speaking truth to power

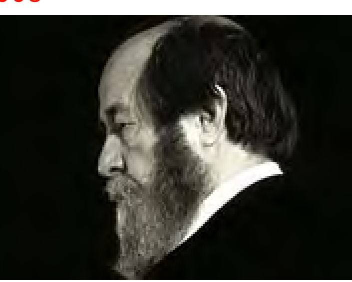
Solzhenitsyn's example and the failure of his heirs



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Print Edition August 9th 2008

Speaking truth to power
Alexander Solzhenitsyn's example—and the heirs who failed him: leader



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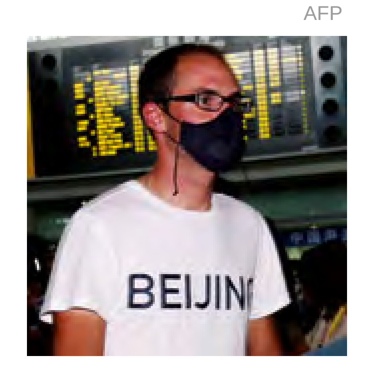
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Politics this week

Aug 7th 2008
From The Economist print edition



AFP

Athletes, some wearing smogmasks, poured into **Beijing** ahead of the Olympic games that begin on August 8th. A massive security operation was mounted in the Chinese capital, but there were several small demonstrations by homeowners who had their houses bulldozed to make way for the games and a protest (by four Westerners) over the status of Tibet. Earlier, 16 Chinese policemen were killed in an attack in the far western city of Kashgar. Officials blamed separatist Muslim militants. See article

The parties in **Pakistan's** ruling coalition reached a provisional agreement to begin impeachment proceedings against the president, Pervez Musharraf, who stepped down as head of the army last November. See article

A Pakistani-born woman suspected of links to al-Qaeda was charged in a New York federal court with trying to kill American officials and soldiers in Afghanistan. **Aafia Siddiqui**, a neuroscientist educated in America, was extradited from Pakistan, but there are conflicting accounts about when, where and by whom she was arrested.

Malaysia's main opposition leader, Anwar Ibrahim, was released on bail after pleading not guilty to charges of sodomy (which remains illegal in Malaysia). Mr Anwar was jailed ten years ago on similar charges before the guilty verdict was overturned.

Rumours of a landslide sparked a stampede down a narrow path from a mountaintop temple in northern **India**, killing at least 145 people. Thousands had made the pilgrimage to the temple in the state of Himachal Pradesh for an annual Hindu festival.

Eleven climbers died, nine on their descent from the summit amid an ice avalanche, on **K2**, the world's second-highest mountain. It was the worst death toll on K2, in Pakistan's Karakoram range, since 1986.

Centralising tendency

Venezuela's president, Hugo Chávez, issued 26 decree laws, the provisions of which could lead to a big increase in the role of state. They will allow the government to intervene in the food industry, add a new militia to the armed forces and create powerful regional officials to rival elected state governors. Meanwhile, Venezuela's supreme court upheld a government ban on dozens of candidates for November's elections for mayors and state governors, including Leopoldo López, who had a strong chance of winning Caracas for the opposition. See article


AP

Two miners were killed in clashes with police during a wave of protests ahead of **Bolivia's** recall referendum, in which the country's socialist president, Evo Morales, hopes to renew his mandate and outwit his opponents in the country's eastern region. Mr Chávez and Argentina's president, Cristina Fernández de Kirchner, cancelled a meeting with Mr Morales in the gas-rich city of Tarija after protesters stormed its airport.

Mexico's government protested at the execution of one of its citizens in Texas. José Medellín, convicted for his part in the rape and murder of two teenage girls, was one of around 50 Mexicans on death row in the United States whom the International Court of Justice ruled should have their convictions reviewed as they were denied access to consular officials after their arrest.

A lot of hot air

America's congressmen began their summer recess amid a row over **energy policy**. Some Republicans returned to an empty House chamber to demand that the Democratic leadership recall legislators so that a bill allowing the expansion of oil and gas drilling could pass. Barack Obama reversed his earlier position and said he supported expansion as part of a compromise. See article

The FBI presented evidence in its case against Bruce Ivins, a government scientist suspected of being behind the postal **anthrax attacks** that killed five people in the aftermath of September 11th 2001. Mr Ivins, a bioweapons researcher at the army's medical research institute, apparently committed suicide in late July. See article

A **military commission** concluded that Salim Hamdan was guilty of materially supporting al-Qaeda when he was a driver for Osama bin Laden, but found him not guilty of conspiring in terrorist attacks. The trial began only recently after four years of legal wrangling over the status of detainees at Guantánamo Bay. See article

French awareness

A **Rwandan** commission accused French officials, including the late president, François Mitterrand, and two former prime ministers, Alain Juppé and Dominique de Villepin, of actively supporting the Hutu *génocidaires* who massacred 800,000 ethnic Tutsis and moderate Hutus in 1994. The French foreign minister expressed outrage and rejected the accusations. See article

Zimbabwe's ruling Zanu-PF and opposition Movement for Democratic Change, currently holding talks in South Africa, issued a joint statement calling on their supporters to stop all forms of violence. It was suggested that a draft agreement was circulating at the talks that would put Morgan Tsvangirai, the MDC's leader, in charge of the country while allowing President Robert Mugabe to continue in a ceremonial role.

Mohammed Suleiman, a security adviser to **Syria's** president, Bashar Assad, was assassinated at a beach resort. Mr Suleiman is thought to have been Syria's liaison with the Lebanese army and the Islamist militia group, Hizbullah.

America and the other five countries involved in talks with **Iran** considered new sanctions after Iran gave a vague answer to questions about its nuclear programme. Iran said it was acting with "goodwill", and promptly announced a test of a new long-range anti-ship missile.

Chronicler of the gulag

AP



Alexander Solzhenitsyn, author of "The Gulag Archipelago", a dissident intellectual and fierce critic of the former Soviet Union who was imprisoned and later deported, died at 89. He had criticised the West during his two decades in exile and returned to Russia in 1994, where he became an admirer of Vladimir Putin. See article

Italy began deploying 3,000 soldiers, some wearing battle fatigues and carrying assault rifles, into city streets across the country to guard embassies, train stations and other areas. The policy remains in effect for six months and was ordered by the centre-right government of Silvio Berlusconi, who won elections in April in part by vowing to crack down on crime. See article

Business this week

Aug 7th 2008
From The Economist print edition

Following their American counterparts, European banks took their turn in reporting quarterly earnings. Net profit at **BNP Paribas**, France's biggest bank, fell by 34% compared with a year earlier; at **Société Générale**, it tumbled by 63%. **Fortis**, a Dutch-Belgian financial company, posted a 49% drop in profit. Britain's **Barclays** said its pre-tax profit in the first half of the year decreased by 33%, to £2.8 billion ($5.5 billion), and at **HSBC** pre-tax profit in the first half was down by 28% at $10.3 billion. The banks reported their earnings a year after the beginning of the credit crunch. See article

American International Group continued to count the cost from its bad investments in the subprime-mortgage market. The world's biggest insurer recorded a quarterly loss of $5.4 billion.

America's Justice Department uncovered the largest case yet of **identity fraud**, involving the theft of more than 40m debit- and credit-card numbers from retailers' computer systems. Eleven people, including several from eastern Europe, were charged.

Still in the driving seat

The board of directors at **General Motors** reiterated its support for the company's chief executive, Rick Wagoner. The carmaker reported a $15.5 billion loss for the second quarter as it booked $9.1 billion in charges and write-downs amid a slump in the North American market. Ford also recently posted a huge net loss, of $8.7 billion.

Chrysler's lending division concluded negotiations with banks over its annual refinancing, and was left $6 billion short. Chrysler Financial had originally sought to renew $30 billion in short-term debt, but could raise only $24 billion. The division, which provides loans to dealers and retail customers, said it was pleased with the deal it had obtained. See article

Detroit's big carmakers were not the only ones to suffer from adverse trading conditions. **BMW** issued a substantive profit warning and said its quarterly profit had dropped by 33% compared with a year ago. The German company made several adjustments to its sales strategy, including diverting some vehicles intended for sale in America to other countries.

Yahoo! held its annual meeting. The company was somewhat embarrassed when it had to issue a new tally of the vote given in support of Jerry Yang, the chief executive, and Roy Bostock, the chairman, after an institutional investor annoyed at Yahoo!'s rejection of Microsoft's takeover bid complained that a glitch in the voting system had not properly captured the "protest" vote. The revised count showed that investors representing 34% of votes cast withheld their support from Mr Yang, and 40% from Mr Bostock.

Bertelsmann agreed to sell its 50% stake in **Sony BMG** to **Sony**, its partner in the venture. The alliance was formed four years ago, so creating the world's second-biggest recorded-music company; the German media group is rejigging its business and the agreement was due to expire next year. Sony BMG will be renamed Sony Music Entertainment. It retains some well-known labels, such as Arista and Columbia, and a stable of stars, including Alicia Keys and Bruce Springsteen.

India's Department of Telecommunications said it would hold electronic auctions to sell space on the airwaves (spectrum) for "third-generation" (3G) mobile-phone networks. The government hopes to raise almost $10 billion from the auctions, which will be open to new entrants, including foreign bidders.

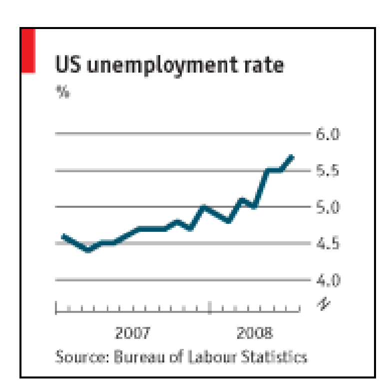
Not working

America's **unemployment** rate in July crept up to its highest level for four years. Meanwhile, America's **economy** in the second quarter grew by 1.9% at an annualised rate, helped in part by the government stimulus payments

posted to households in May.

Xstrata held good to its intention of diversifying its metals business by launching a $10 billion unsolicited takeover bid for **Lonmin**, a big producer of platinum.

The **price of oil** closed below $120 a barrel on August 5th for the first time since early May.



High energy

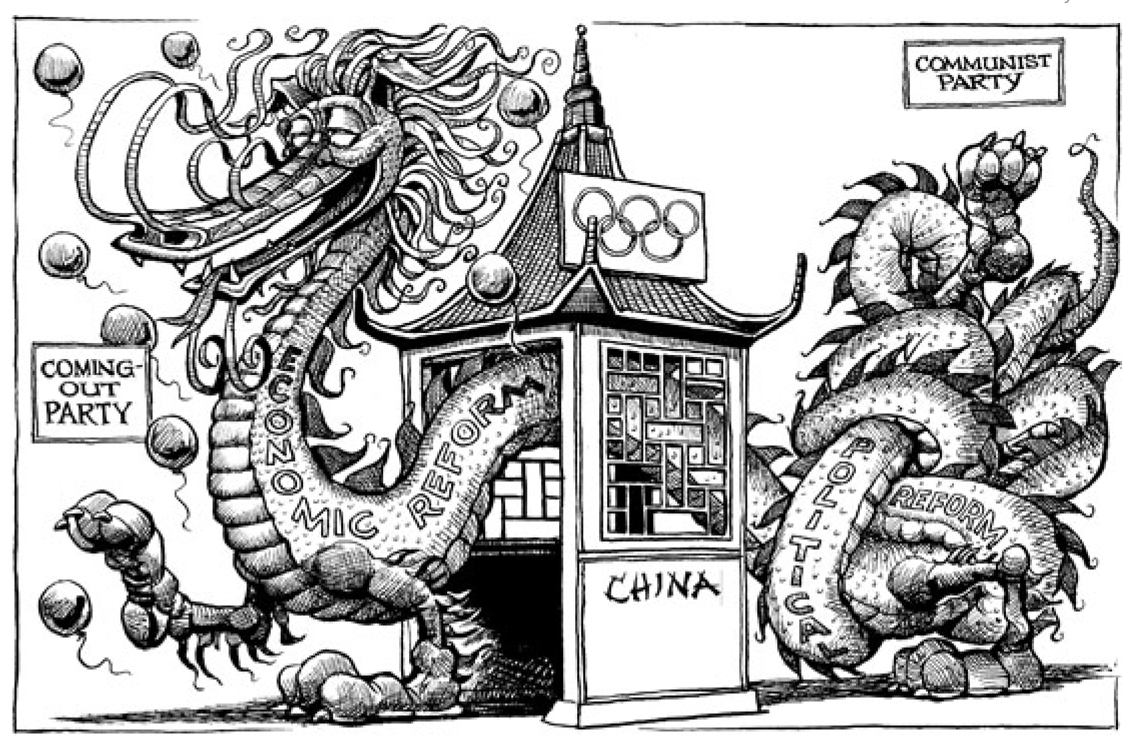
Steep oil prices helped boost profits at oil companies, offsetting weak performances in production and refining. **Chevron** reported quarterly net income of $6 billion, as did France's **Total**. **Exxon Mobil** made a record corporate quarterly profit of $11.7 billion.

Whole Foods Market announced a much-reduced quarterly profit and said it would open fewer new stores than it had intended over the next year. The natural-food retailer's nickname is Whole Paycheck, but sales have slowed as customers forgo ingredients for their arugula and fennel salad so that they can afford to fill their cars.

KAL's cartoon

Aug 7th 2008
From The Economist print edition

Illustration by KAL



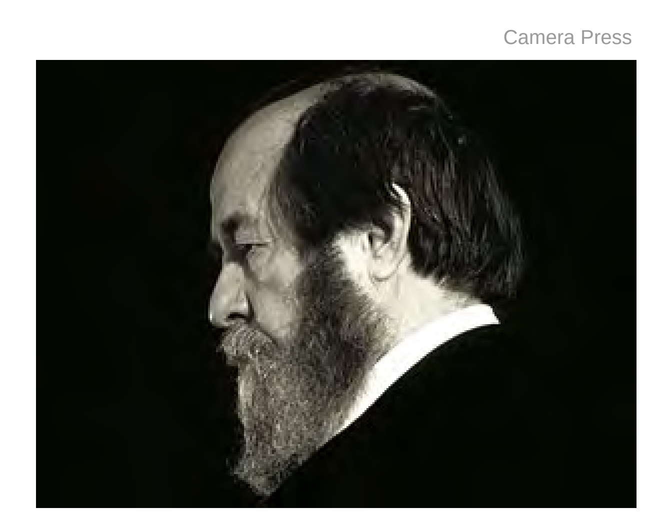
Alexander Solzhenitsyn

Speaking truth to power

Aug 7th 2008
From The Economist print edition

Alexander Solzhenitsyn's example—and the heirs who failed him

Camera Press



GEORGE KENNAN, the dean of American diplomats, called "The Gulag Archipelago", Alexander Solzhenitsyn's account of Stalin's terror, "the most powerful single indictment of a political regime ever to be levied in modern times". By bearing witness, Solzhenitsyn certainly did as much as any artist could to bring down the Soviet system, a monstrosity that crushed millions of lives. His courage earned him imprisonment and exile. But his death on August 3rd (see article) prompts a question. Who today speaks truth to power—not only in authoritarian or semi-free countries such as Russia and China but in the West as well?

The answer in the case of Russia itself is depressing. Russia's contemporary intelligentsia—the should-be followers of the example of Solzhenitsyn, Sakharov and the other dissident intellectuals of the Soviet period—is not just supine but in some ways craven (see article). Instead of defending the freedoms perilously acquired after the end of communism, many of Russia's intellectuals have connived in Vladimir Putin's project to neuter democracy and put a puppet-show in its place. Some may genuinely admire Mr Putin's resurrection of a "strong" Russia (as, alas, did the elderly Solzhenitsyn himself). But others have shallower motives.

In Soviet times telling the truth required great courage and brought fearful consequences. That is why the dissidents were a tiny minority of the official intelligentsia which the Soviet Union created mainly in order to build its nuclear technology. Today it is not for the most part fear that muzzles the intellectuals. Speaking out can still be dangerous, as the murder in 2006 of Anna Politkovskaya, an investigative journalist, showed. But what lurks behind the silence of many is not fear but appetite: an appetite to recover the perks and status that most of the intelligentsia enjoyed as the Soviet system's loyal servant.

The problem of authoritarianism

In China the intellectuals' silence is easier to forgive because voicing dissent is still sharply controlled. For all its new openness, China has created few opportunities for Solzhenitsyn-type greats to emerge. It has tolerated a modicum of writing about the horrors of the Cultural Revolution, but then the government too now says the Cultural Revolution was horrific. You would search in vain in China itself for literature about the misery of the 1950s after the communists took over, or the deaths of tens of millions in the famine of the early 1960s. The window opened a bit in the 1980s, but the Tiananmen crackdown in 1989 banished

free thinking well into the 1990s.

The emergence of the internet and a market-driven publishing industry has changed China less than it should. Several intellectuals post critical views of the party online. A good example is Hu Xingdou, an academic who lays into the party at every opportunity. But not even he goes as far as to call for the end of one-party rule. In 2004 a Chinese newspaper caused a stir by publishing a list of 50 public intellectuals. They included Gao Yaojie, who helped expose an AIDS epidemic in Henan, Wen Tiejun, who has written about the suffering of peasants, and He Weifang, a law professor who has spoken out about the rights of the marginalised, such as migrant workers.

These are impressive people, to whom China will one day be grateful. But the voices of the dissidents count for less than they did in the 1980s. China then, like the Soviet Union, was a bleak place with little other intellectual stimulation. People yearned for provocative ideas. Now access to information is freer, the economy is flourishing and for a lot of intellectuals life is good. China has its bold thinkers, but in its present mood it is hard to imagine one of them galvanising an entire class the way Solzhenitsyn did.

It is a bit too easy for people in the West to deplore the failure of intellectuals living in unfree societies to follow the example of a Solzhenitsyn. Such stories are rare. His arose from an unusual confluence: a great crime, a great silence, a receptive audience and personal courage well above the ordinary. There are parts of the Islamic world where secular thinkers, such as Egypt's Nobel novelist, Naguib Mahfouz, have faced violence for daring to prick a suffocating conformity. The Western intellectual, by contrast, enjoys a charmed existence. In France, which pampers its men of ideas, De Gaulle is reputed to have ordered the release of the inflammatory Jean-Paul Sartre in 1968 by remarking, "You don't arrest Voltaire." Most democracies have pulled off the remarkable feat of creating in the universities a class of tenured academics whose salaries are paid by the state but who are free, and often inclined, to savage the hand that feeds them. Nice work, if you can get it.

The problem of democracy

The West has printed a lorryload of angst-ridden books about the demise of the intellectual. Political correctness and academic over-specialisation have indeed hurt the quality of much that is said in the media and taught in the universities. But at the root of most complaints is the supposed problem of surplus. Authoritarian places nurture a class of recognised intellectuals whose utterances are both carefully listened to and strictly controlled. Democracies produce a cacophony, in which each voice complains that its own urgent message is being drowned in a sea of pap. "Repressive tolerance", one ungrateful 1960s radical called it. It would cause not a ripple if MIT's famous intellectual subversive, Noam Chomsky, were invited to speak to the annual capitalist jamboree in Davos.

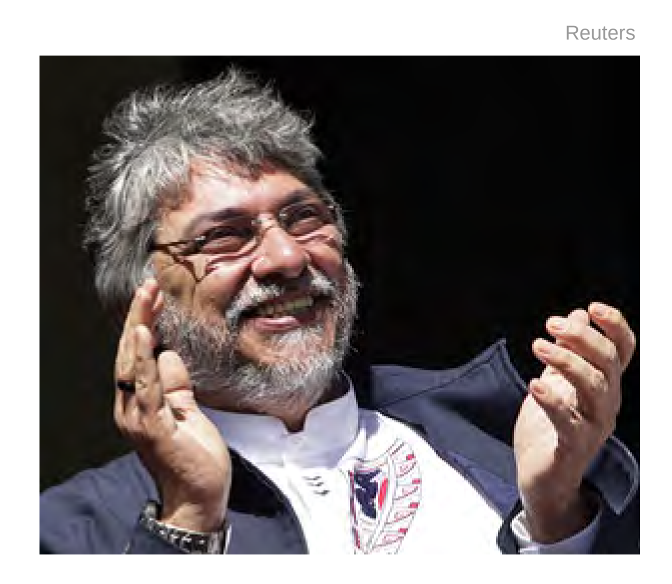
The cacophony is the lesser evil. Ideas should not be suppressed, but nor should they be worshipped. Kennan was right to call "Gulag" a powerful indictment of a regime. Remember, though, that in 1848 two well-meaning intellectuals published another powerful indictment of a system, and their "Communist Manifesto" went on to enslave half mankind. There is no sure defence against bad ideas, but one place to start is with a well-educated and sceptical citizenry that is free to listen to the notions of the intellectuals but is not in thrall to them—and, yes, may prefer the sports channel instead. The patrician in Solzhenitsyn hated this lack of deference in the West. That is one respect in which the great man was wrong.

The bishop of democracy

Aug 7th 2008
From The Economist print edition

A welcome for another left-wing leader; but expect the pendulum to start swinging to the right

Reuters



APART from featuring in a couple of novels by Graham Greene, Paraguay has rarely attracted the attention of outsiders. It is a poor, sweltering, landlocked tract of South America with only 6m people, many of Amerindian descent. But it enjoys a sad distinction. For the past 61 years it has been in the grip of the world's longest-ruling party, the Colorados, first under the kleptocratic dictatorship of General Alfredo Stroessner and then under his only slightly less grasping civilian acolytes.

It is not surprising that it took a man who might have walked off the pages of a Greene novel to end Colorado misrule. Fernando Lugo, who takes office on August 15th, was at the time he won the presidential election in April still technically a Catholic bishop (the Vatican has since accepted his resignation). He is a bearded, sandal-wearing liberation theologian, a campaigner for the poor and for land reform (see article). He is also a political novice who heads a disparate coalition whose span extends from the centre to the hard left.

Mr Lugo takes his place in a cohort of left-wing leaders who have come to power in Latin America in the past few years. So expect much comment in the next few days to the effect that the region is moving irrevocably and uniformly towards socialism and away from the influence of—or if you prefer, domination by—the United States.

The reality is more complex. First, the centre-right still holds sway in some places, such as Mexico, Colombia and Peru. And, second, the differences between the region's left-wing leaders are more important than the similarities. Although neither leader says so publicly, there is little in common between Hugo Chávez's autocratic military socialism in Venezuela and the pragmatic social democracy of Brazil's Luiz Inácio Lula da Silva. Mr Lugo's brand of leftism might well be closer to Lula's than to that of Mr Chávez, but he will be his own man.

There are some common threads in the stories of how these left-wing leaders have come to power. They include widespread poverty, deep inequalities of income and the economic difficulties that the region suffered a decade ago (which, though partly due to external events, eroded faith in the centre-right leaders then in office). Yet the left would be mistaken in imagining that it has a permanent lease on power.

Kicking the bums out

That is because another factor behind the recent success of the Latin American left is the fresh vigour of democracy in a region where dictatorship was once common. Democracy cuts many ways politically: Latin American voters, like those elsewhere, will punish governments that disappoint.

The past few years of rapid economic growth have helped incumbent governments of all sorts. The next period looks tougher. To make matters worse for the incumbents of the left, the two issues now uppermost in Latin American minds are inflation and crime, which both tend to move votes to the right. That gives the centre-right an opportunity to regain ground—though the conservatives will need to arm themselves with credible policies both to reduce poverty and to promote equality of opportunity.

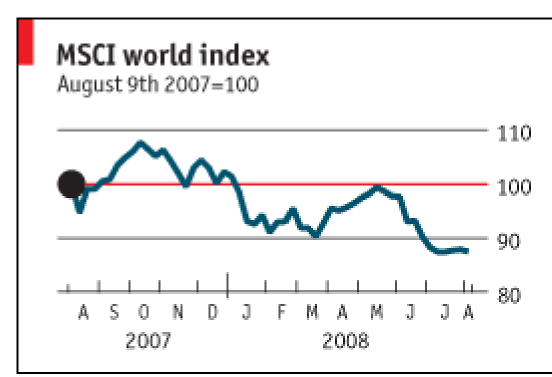
The political tide may turn in elections next year for president in Chile and for Congress in Argentina. So welcome Mr Lugo, because Paraguay desperately needs change and a democracy worth the name. But expect Latin America's political pendulum to start swinging.

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The year of living dangerously

Aug 7th 2008
From The Economist print edition

As the crunch grinds past its first anniversary, central banks' credibility is still at risk



ON AUGUST 9th 2007, after an alarming leap in interbank interest rates, the European Central Bank signalled its readiness to provide the banking system with the liquidity it suddenly lacked. What became known, with irresistible alliteration, as the credit crunch had begun. A year on, the crunch continues. Indeed, recent data suggest that Europe and Japan are flirting with recession. America has so far stood up surprisingly well; but banks there (and elsewhere) are still in pain.

Worse, a second shock—higher commodity prices—has made life doubly difficult for central banks. The combination of dearer commodities and a squeeze on credit has presented them with a conflict between their two main tasks: preserving the health of the financial system and controlling inflation.

To date, the central banks have just about passed the test. Their willingness to provide liquidity has prevented financial markets from melting down completely, despite some hairy moments. And the recent decline in oil prices may ease their worries about inflation.

But there have been many embarrassments along the way. The financial system was not as robust as most regulators thought. Banks had not shed risk altogether; it was hidden off their balance-sheets. The British tripartite system of oversight was ineffectual in the Northern Rock crisis. Inflation has been well above target rates in Britain and the euro area and outside the comfort zone of America's Federal Reserve.

Worst of all, perhaps, is the perception that central banks have acted out of a desire to rescue their "friends" in the financial sector. Steelworkers and coalminers have to face grim economic reality and see their companies liquidated; bankers, it seems, do not. As Nouriel Roubini, an American economist, has remarked, this smacks of "socialism for the rich".

The reason for saving a big financial institution that gets into trouble is the economic havoc its failure can cause. The historically minded need no reminding of the Great Depression—least of all Ben Bernanke, the Fed's chairman, an expert on the subject. It seems plausible that, even if the risk of catastrophe is slight, no chances should be taken. To borrow the title of a popular book: shoot black swans on sight.

We are all Keynesians again

The problem is that trigger-happy intervention also has its drawbacks. It has long been accepted that retail depositors should be protected, to maintain their faith in the financial system. But ten years ago the Fed helped organise the rescue of Long-Term Capital Management, a hedge fund (although no public money was involved). This year it went further and gave guarantees to Bear Stearns, an investment bank with no retail depositors. Last month it played its part in shoring up Fannie Mae and Freddie Mac, the twin quasi-private giants of the American mortgage market. If financial institutions are deemed too big and too complex to fail, their managers will have an incentive to make them big and complex.

All this is reminiscent of the history of Keynesian economics. John Maynard Keynes explained how a sudden drop in investment could lead to a long-lived slump, because prices, wages and interest rates would not adjust enough to encourage fresh spending. The solution was for governments to provide the demand needed to return to full employment. By the 1960s and 1970s, Keynesian demand management

was being used to try to avoid any kind of downturn. The result was an expansionary bias in policy and, eventually, inflation.

The “no bank left behind” policy of central banks has not yet led to the kind of inflation seen in the 1970s. But cutting interest rates as a first response to any distress in the financial sector has helped to blow bubbles in asset prices—dotcom stocks in the late 1990s, house prices in the 2000s. And it has led to a speculative mentality in financial markets, demonstrated by the importance of trading to investment banks’ profits. Why not take risks, if you know that central banks will intervene only in falling, not rising, markets?

The idea of giving central banks independence was that they would take decisions from which politicians would shrink. The central banks’ credibility depends on being prepared to do two unpopular things: raising interest rates, despite the economic pain, and letting financial institutions fail.

With interest rates that independence is (or should be) easy to maintain. Rescues are harder: public money benefits some firms and not others, and political pressure is easier to exert. Alan Greenspan, the previous Fed chairman, has one answer: a new, separate body to deal with bank rescues (see article). The central bankers would be consulted, of course, but the decision on whether to use taxpayers’ money has to rest with elected politicians. In practice, this could be hard to achieve, but he has identified one principle. Central banks’ credibility should be focused where it is most needed, on controlling inflation. That credibility was too hard-won to be tossed away.




Anglicans

United we fall

Aug 7th 2008
From The Economist print edition

The writhings of worldwide Anglicanism are another reason to disestablish the Church of England

Reuters



IN THE end it held together, but only just. The 650-odd bishops who attended the once-a-decade Lambeth conference went home with open schism between the liberal and conservative wings of the worldwide Anglican Communion averted. A split may prove no more than postponed, as the agreed mechanisms for making minds meet are oh-so-slowly put in place (see article). But at least the unedifying spectacle of comrades in Christ tearing strips off each other over gay sex will vanish from the headlines for a bit.

Does it matter if Anglicans fall out? Most churches are riven by tensions: it is not so long ago that the Roman Catholic Opus Dei glared at liberation theologists, and Moscow's Orthodox still squabble like mad with Constantinople's. But Anglicans lack the glue that binds those churches together: the power of the pope to impose discipline on straying Catholics; the body of undisputed theology that unites Orthodox believers even when they quarrel. Anglicanism works through relationships, a sense of belonging to a family with a shared inheritance. That now has waned. Despite the apparent reprieve, this year's Lambeth conference could well be the last of its kind.

As a secular newspaper that supports gay marriage and believes in a firm line between church and state, we can hardly claim to be a neutral observer in this. Yet trying to look at the Communion from an Anglican perspective (or that of most of them), two things stand out. First, schism might not be a bad thing. And disestablishment would be a very good thing.

Good and bad reasons to stick together

The first point is simple realism. Too many angels have danced on too many pins as prelates struggle to embrace mutually incompatible beliefs. The rock on which the Anglican Communion is breaking is ostensibly the consecration of openly gay clergy, especially bishops, and blessings for same-sex unions. Only a small minority in America's well-groomed Episcopal churches or the Church of England's underpopulated pews finds clerical homosexuality non-negotiably bad nowadays. Many in Africa and other parts of the "global South" do—and they see efforts to enforce liberal values as "colonial".

Attempting to find a way to square this circle has not been an inspiring task. Some argue that liberals must hang in there to rein in the homophobes and misogynists. In fact, too often it is the high ground that gives. The gay American bishop whose promotion launched the latest round of internecine bitterness

was not invited to Lambeth. Conservative rebels refused to come anyway. If someone did manage to bury this bone of contention, another would emerge. So why haven't liberals and conservatives gone their separate ways before now?

One reason is the sheer weight of history, but this is less important than it was. Another is that most upstarts would rather take over an existing business than go off and start their own—and in Britain, at any rate, Anglicanism's heirs are in for some serious real estate too. A third is the fact that the Church of England, alone of the Communion, is an established church, its practices and values intertwined with the state and nation it serves. Its peculiar status has inclined it to fudge the argument.

Establishment brings fewer material advantages to the Church of England these days than the Lutherans, for example, enjoy in much of Scandinavia. And a creeping disestablishment is under way. Yet centuries of crowning kings, burying princesses, celebrating the nation's victories, running a lot of its state-funded schools and getting Parliament to cast an eye over the decisions of its ruling General Synod have made the Church of England what it is. It prides itself on keeping the door open to all comers, though few pop in. It stresses inclusiveness and stands up for a public space for all faiths. Admirable stuff—but its numbers are falling.

Compare that with churches in America, or Africa. No theocrats they, but fishers of men in competitive waters. Their messages must be more sharply defined to win souls. But by keeping the focus soft, as an established church must, the Church of England, which dominates this least authoritarian of associations, has blunted the contest of ideas and distorted debate within the Communion (and its own ranks). Time, surely, for all sides to fight their corner, free of the shackles of the state.

Business in Japan

Take a leaf out of his book

Aug 7th 2008
From The Economist print edition

Japanese bosses can learn from the country's favourite businessman—even if he does not exist

Kenshi Hirokane-Kodansha Ltd



YAMATO, the ancient name of Japan, essentially means "big harmony". To achieve such balance, Japanese society has refined a plethora of cultural traits: humility, loyalty, respect and consensus. In the field of business, however, this often results in a lack of leaders who are willing to stand out from the crowd, promote themselves and act decisively. "The nail that sticks up gets hammered down" is a common Japanese refrain; "the hawk with talent hides his talons" is another. Whereas American and European bosses like to appear on the covers of global business magazines, their Japanese counterparts are comfortable in their obscurity. Business in Japan is generally run as a group endeavour.

Such democratic virtues served the country well in the post-war period. But today they hold too many Japanese firms back. Japan boasts some of the best companies in the world: Toyota, Canon and Nintendo are the envy of their industries. But they operate on a global scale and have tentatively embraced some unconsensual American methods. In much of the Japanese economy—especially its huge domestic services sector—managers are in something of a funk. Firms do not give promising youngsters responsibility early on, but allocate jobs by age. Unnecessarily long working hours are the norm, sapping productivity. And there are few women and foreigners in senior roles, which narrows the talent pool.

So how pleasing it is to be able to report the success of a business leader who breaks the mould. Young, dynamic and clever, he is not afraid to push aside old, conservative know-nothings. He disdains corporate politics and promotes people based on merit rather than seniority. He can make mistakes (he got involved in a questionable takeover-defence scheme), but he is wildly popular with salarymen: his every move is chronicled weekly. In June he was given the top job at one of Japan's biggest firms. Kosaku Shima of Hatsushiba Goyo Holdings has only one serious shortcoming: he is not a real person, but a *manga*, or cartoon, character (see article).

For many critics of Japan, that says it all: Mr Shima could exist only in fiction. In fact there is room for the country's managers and even its politicians to learn from him.

Most of the lessons are for Japan's managers. At present, bosses rarely say what they think because it might disrupt the harmony, or be seen as immodest. Their subordinates are reluctant to challenge ideas because that would cause the boss to lose face. So daft strategies fester rather than getting culled quickly. There is little risk-taking or initiative. The crux of the problem is Japanese companies' culture of consensus-based decision-making. Called *nemawashi* (literally, "going around the roots") or *ringi* (bottom-up decisions), it helped to establish an egalitarian workplace. In the 1980s Western

management consultants cooed that it was the source of Japan’s competitive strength. Sometimes it can be, as in periods of crisis when an entire firm needs to accept new marching orders quickly. But most of the time it strangles a company.

Relying on consensus means that decisions are made slowly, if at all. With so many people to please, the result is often a mediocre morass of compromises. And with so many hands involved, there is no accountability; no reason for individuals to excel; no sanction against bad decisions so that there are fewer of them in future. Of course, sometimes the consensus of the Japanese workplace is just a veneer and decisions are still made from on high. But then why persist with the pretence, particularly if it drains a company’s efficiency?

Time to turn the page

If the onus is on Japanese managers to change, then it is fair to say that the government does not make it very easy for them to do so. The biggest problems lie in the labour market. Change jobs in mid-career and you risk losing your pension. The rigid seniority system also discriminates against women: if they get off the ladder to have children, they cannot get back on. And although there is no law against closing down loss-making businesses, most bosses and politicians act as if there were. If Japan’s leaders decide their country needs more people like Mr Shima—and it surely does—then they might reflect on all the ways that they prevent him from becoming a reality.



On the American economy, Russia's policy on Zimbabwe, the credit crunch, organic milk, political behaviour

Aug 7th 2008
From The Economist print edition

Time for a change?

SIR – Your leader on America’s recent woes displayed a somewhat dogmatic faith in the superiority of the market (“Unhappy America”, July 26th). You suggested, for example, that America’s school system should be driven by competition, citing the remarkable results achieved by America’s universities. But, based on international comparisons, there is no evidence that competition in primary or secondary education has a positive influence overall. America’s health-care system is based on private insurance and care, yet it performs poorly compared with countries that provide universal health insurance (the norm in the developed world). Reform may be needed, but there is no reason to assume that markets have the answer.

Moreover, the credit bubble was the result of an exaggerated confidence in the ability of “the market” to spot and address its own excesses. The main flaw in the regulatory system was the lack of political will to interfere. Ironically, that same system is now being used to implement quite drastic government measures.

On another topic entirely, your claim that Guantánamo is the “most un-American place on the planet” is disingenuous. It was set up by an elected American administration and has been tolerated by the judiciary and Congress. Nor is it wholly unprecedented. America has condoned and even encouraged the use of abduction, extra-judicial killings and torture whenever they were deemed necessary in the fight against the evils of the time, as evidenced by the involvement of American “advisers” in many unsavoury but so-called friendly regimes, from Chile under Pinochet to Iran under the Shah.

Michel Hubert
Paris

SIR – Your claim about Guantánamo leads me to wonder if you read your own newspaper. Although Guantánamo is clearly a blight on American ideals, your coverage of such places as Myanmar, North Korea, Sudan, and Zimbabwe reveals your choice of hyperbole to be absurd.

Eben Watt
Victoria, Canada

SIR – Americans may well be unhappy, and rightfully so. After all, it was Americans who chose to take adjustable-rate mortgages and suffer the consequences. It was American banks that lined up to provide these short-term low fixed-rate notes when the lure of transaction fees overruled their cautious lending guidelines. It was American investors who chased higher returns without any careful examination of the underlying pools of collateral, providing more money for these overzealous banks to lend. Greed overcrowded our senses and sound judgment was thrown to the wind.

If Americans share one attribute it is being held to account. We will learn from our mistakes, that you cannot consume more than you produce, or live in houses you cannot afford. But what we will not consider is our government having to bail us out. This is the true root of our unhappiness.

David Annanders
Beverly Hills, California

Russia’s policy on Zimbabwe

SIR – Russia doesn’t seem to be able to do much right, as far as *The Economist* is concerned. Your article

on Russia and the United Nations simultaneously took us to task for changing policy on Zimbabwe while criticising us for not altering foreign policy at all ("The return of Mr Nyet", July 19th). Actually, the foreign (and domestic) policies of President Dmitry Medvedev are consistent with those under Vladimir Putin, because they have the overwhelming support of the Russian public.

Regarding Zimbabwe, our insistence on removing support for sanctions from the G8 communiqué was consistent with our policy. We believe that negotiations between the government of Zimbabwe and the opposition are the best way to avoid more bloodshed. With China, we vetoed the draft UN Security Council resolution for the same reason, and are not alone in this belief. We took our lead from South Africa and other regional powers that are working actively for a peaceful solution in Zimbabwe. The African Union explicitly called on the international community to avoid steps that would derail negotiations.

As a matter of principle, we do not believe in the punishment or isolation of sovereign states. We do believe in regional solutions whenever possible. But at the same time, we have made it clear to the Zimbabwean authorities that our UN vote should be seen as a chance to reach a workable compromise with the opposition to benefit the country's citizens, not as an excuse to do nothing.

Alexander Kramarenko
Director of policy planning Ministry of Foreign Affairs
Moscow

An author's reply

SIR – Your review of my book, "The Credit Crunch", asserted that "it is not clear" I understand free trade because I had written: "free trade today is no longer driven by comparative advantage, rather the ability to maximise profits by cutting costs" ("The usual suspects", July 12th). You are right in stating that the point of free trade "has always been to" maximise profits and cut costs, but the quote you took is selective. In the following sentence I went on to say that "the cost advantage enjoyed by many developing countries is so great, that it has been impossible for many manufacturing industries in the industrialised West to compete". This has not always been the case.

It is a key feature of free-trade policy pursued since the creation of the World Trade Organisation in 1995, and explains why we have lost so many manufacturing jobs in recent years. In turn, that has necessitated a loose monetary policy. This remains the underlying problem behind the emergence of grotesque housing bubbles in the West.

Today's central banks are in danger of repeating the mistakes made by the Bank of Japan in the 1990s. This was a substantive and important area of my book that you overlooked. It is a pity that the review did not add to the debate about how we are going to rescue ourselves from the horrible mess these free-market policies have created.

Graham Turner
London

Organic milking

SIR – I noticed, in an article on inequality, that some consumers assume that organic milk is of "better quality" than normal milk (Economics focus, July 26th). Some well-off households may have fallen for the charlatans and well-meaning dreamers who have successfully persuaded an uncritical media about the benefits of "organic" cultivation, despite the lack of supporting science. Poorer households are better off buying the lower priced, but equally nourishing, normal stuff.

Roger Tatchell
Klanxbüll, Germany

Shared political attributes

SIR – So, Britain's Conservatives are adopting the fashionable ideas of behavioural economists and want

to “nudge” people who are “fallible: lazy, stupid, greedy and weak; loss-averse, stubborn, and prone to inertia and conformism...poor decision-makers, often incapable of their own happiness” (Bagehot, July 26th). Someone should tell David Cameron that governments consist of the very same kind of people.

Ken Good
Los Angeles

Russian intellectuals

The hand that feeds them

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From The Economist print edition

Gary Neill



Individual voices are brave. But Russia's intelligentsia, which could be much freer than in the bad old days, is still mealy-mouthed

THEY did not like each other much, Alexander Solzhenitsyn and Russia's liberal intelligentsia. Solzhenitsyn, who in the West was considered its paramount flower, was as rude about it as he was about almost everything else. He refused to use the word intelligentsia, engineering instead the ugly and pejorative *obrazovanshchina*, roughly "educatedness". The intelligentsia responded in kind: it paid tribute to his courage, read his works in *samizdat* but was spooked by his anti-Western attitude and refused to recognise him as one of their number.

His main charge was that the intelligentsia had failed in its most vital task—to speak on behalf of the people suppressed by an authoritarian state. Members had become part of the system, allowing themselves to get comfortable in its nooks and crannies. "A hundred years ago," he wrote in 1974, "the Russian intelligentsia considered a death sentence to be a sacrifice. Today an administrative reprimand is considered a sacrifice." He spelt out his commandments in capital letters: "DON'T LIE! DON'T PARTICIPATE IN LIES, DON'T SUPPORT A LIE!"

When Solzhenitsyn wrote in this way, few dared to argue publicly with the great Russian writer-in-exile. But when he returned to Russia in 1994 he became a figure from the past. Few famous writers or artists came to pay respect as he lay in state. The most prominent faces were those of Vladimir Putin and Mikhail Gorbachev.

"The Gulag Archipelago", published in 1973, had shaken the very foundations of the Soviet system, but it did not make the country immune from the restoration of Soviet symbols and elements. Russia today is ruled by the KGB elite, has a Soviet anthem, servile media, corrupt courts and a rubber-stamping parliament. A new history textbook proclaims that the Soviet Union, although not a democracy, was "an example for millions of people around the world of the best and fairest society". Mr Putin bears a large share of responsibility for all this, but that does not exempt the Russian intelligentsia from its share. Putinism was made strong by the absence of resistance from the part of society that was meant to provide intellectual opposition.

Shortly before Mr Putin was due to stand down as Russia's president, Nikita Mikhalkov, a prominent Russian film director, together with a couple of Mr Putin's other fans, wrote a letter "on behalf of Russian artists" pleading with him to stay in power. The letter provoked indignation and an open letter from an opposing camp, telling Mr Putin to go. The two letters were a blip on the intelligentsia's cardiogram, which had been showing few signs of life. The death of its greatest intellectual is likely to become another blip on the same largely dormant machine.

The very word intelligentsia is a Russian invention. In the West it usually evokes the image of a talented intellectual, otherworldly, harassed by the state, soulful and conscientious. But the Soviet intelligentsia was different. It was summoned into being by the state for a particular purpose, one that had little in common with its 19th-century antecedents.

In Tom Stoppard's trilogy about 19th-century Russian intellectuals ("The Coast of Utopia"), Alexander Herzen laments that Russia has made no contribution to philosophy and political discourse. "Yes, one! The intelligentsia," retorts one of his friends. "Well, it's a horrible word," comments another. "What does it mean?" asks Herzen. "It means us. A unique Russian phenomenon, the intellectual opposition considered as a social force."

Don't feel too pleased with yourselves

What is the influence of the intelligentsia today?
% of total, October 2006

No influence	40
Its influence is not strong	39
Its influence is quite significant	11
Its influence is very strong and significant	3
It's hard to answer	7

What role do you think the intelligentsia and educated people should play in relations between the power [the authorities] and the people?
% of total, February 2008

They should serve the interest of the people and protect them from pressure from the authorities	41
They should be an intermediary and smooth away conflicts between the power and the people	19
They should help the power to set the energy of people onto the right track	16
They should stay away from the relations between the power and the people and not interfere	9
It's hard to answer	15

Source: Levada Centre

Mr Stoppard's characters are strangers in today's Russia. Their hatred of autocracy, their lacerating criticism and their ability to articulate the concerns of the oppressed seem naive and out of date. Has the Russian intelligentsia lost its social force or its intellectual power? Or does the phenomenon exist only in an authoritarian society with no functioning parliament? Was Solzhenitsyn right in his diagnosis of the Russian intelligentsia, that it amounted to no more than people with diplomas and good jobs?

Solzhenitsyn was certainly not the first Russian intellectual to criticise the intelligentsia. Self-criticism and repentance have long been part of its identity. In "Vekhi", an important self-reflecting book written in 1909, Sergei Bulgakov describes the sorry state of the intelligentsia, its conceit towards its own people, its lack of discipline and decency. "Russian society, exhausted by preceding tension and failures, is in a state of some numbness and apathy, spiritual disjunction and depression...Russian literature is flooded by a muddy wave of pornography and sensationalism."

Bolshevik Russia had no need for reflective thinkers like Bulgakov. He was among the first Russian philosophers to be expelled by Lenin in 1922. Many of his readers vanished into prison camps.

Come into my parlour

Lenin and Stalin wiped out the old Russian intelligentsia as a political force. Yet, as culture-centric dictators, they bribed and remoulded the finest examples to their own needs. For example the Moscow Art Theatre, which embodied the Chekhovian intelligentsia, was gradually converted into a Soviet institution. Its actors were showered with privileges and comforts, were allowed to travel abroad and could rest in government sanitariums for as long as they could lend their art to the purposes of the Bolshevik state. In the late 1920s the Soviet government started to give out large plots of land to selected artists, scientists and engineers in a special compound.

Vasily Kachalov was a Moscow Art Theatre actor who played Chekhovian parts. According to his son, he dealt with the ambiguity of his new position by heavy drinking. And when drunk he cursed himself for allowing the state to see him as a symbol of continuity between the Russian and Soviet intelligentsia.

In fact it was scientists, physicists particularly, who were at the core of the Soviet intelligentsia as a social phenomenon. Andrei Zorin, a historian at Oxford, argues that the intelligentsia was largely the product of nuclear research. Stalin needed a nuclear bomb and realised that scientists' brains do not work unless you allow them a certain amount of freedom. The conditions created for the scientists were close to ideal: they had status, money, equipment and no distractions. "Science was the favourite child in the hands of the government," says Vladimir Fortov, a member of Russia's Academy of Science. "It was prestigious and well paid. We could do our research and not concern ourselves with anything else."

Russian nuclear physicists were settled in closed or semi-closed towns and housed not in barracks but in attractive cottages, which resembled Swiss chalets or small Russian mansions, amid forests. The best Russian scientists were exempted from joining the Communist Party and had direct access to the Kremlin. The fact that Andrei Sakharov was one of Russia's top nuclear physicists, the father of the first Soviet

hydrogen bomb, and a man who had direct contact with Lavrenty Beria, the security chief, gave special power and meaning to his dissent.

The scientific colonies were well supplied not only with food but also with culture. The political clout which scientists possessed allowed them to invite artists who were not allowed to perform before larger audiences. Vladimir Vysotsky, an iconic Russian poet, singer and rebel, gave one of his first public concerts in Dubna, a nuclear-research town.

Russia's military needs led to an overproduction of all kinds of scientists, matched by a hyper-production of culture, says Mr Zorin. The consumers of this culture were the millions of engineers and scientists who worked in research institutes and construction offices with a postbox number for an address. In reality, the Soviet economy could not accommodate them all: as the Soviet joke had it, they "pretended to work and the state pretended to pay".

A large number of educated, intelligent and underemployed people in their 30s and 40s with little prospect of moving up the career ladder provided a perfect milieu for brewing liberal ideas. With time, they formed a political class. They were not dissidents and they relied on the state for provisions, but they were fed up with the restrictions imposed by Soviet ideology and they were critical of the system.

They wanted to live "like people do in a civilised world", they wanted to travel abroad, get food without queuing and have access to information. But they neither anticipated nor desired the dismembering of the Soviet Union.

It was this political class of intelligentsia that prepared for *perestroika* and became the main support base for Mikhail Gorbachev. *Perestroika* offered everything that the intelligentsia desired while still keeping the Soviet Union in place. The late 1980s were, perhaps, the happiest years for the intelligentsia, combining a degree of freedom of expression with continuing state support. When in August 1991 Communist and KGB hardliners mounted a coup against Mikhail Gorbachev, hundreds of thousands of the Russian intelligentsia gathered in front of parliament to defend the achievements of *perestroika*.

"I think of August 1991 with great tenderness and nostalgia. I thought then it was one of the highest moments in Russian history, that it would become a national holiday," says Lev Dodin, the artistic director of the celebrated Maly Drama Theatre. Boris Yeltsin, tall, handsome, with a shock of white hair, standing on a tank and speaking on Mr Gorbachev's behalf, was an image made for canonisation.

Beginning of the end

But the day when the KGB-inspired coup was defeated has not become a national holiday, and its tenth anniversary was celebrated with the restoration of the Soviet national anthem. The paradox was that the intelligentsia's triumph—which led to the collapse of the Soviet empire—was also the beginning of its end. Soviet intelligentsia and the state were joined at the hip. When the state went, so did the intelligentsia. The defeat of the coup did not become an ideological watershed; it was not celebrated as the birth of a new nation, only as the collapse of the old one.

Having smashed the bell jar which it inhabited, the intelligentsia felt disoriented. The contract—under which the intelligentsia barked at the state and the state occasionally hit back but continued to provide support—was broken. The state no longer needed intellectuals. It needed managers and businessmen able to avert starvation and total economic collapse. The intelligentsia had nurtured the cult of the persecuted and consecrated its own heroic struggle (a censor's ban was a badge of honour). But it was caught unprepared for the practical and mundane tasks of building state institutions.

A large number of scientists left the country. Some went into business (most Russian oligarchs of the Yeltsin era, including Boris Berezovsky, were scientists in previous lives). A few took jobs in government. Some intellectuals dedicated themselves to human rights. But, as a class, the intelligentsia did not create lasting democratic institutions or solidify the freedoms granted in 1991.

Russia's media engaged in an exercise of self-deprecation and sneering. Almost nobody was prepared systematically to study the country's history. According to Mr Dodin, one of Russia's most thoughtful and influential theatre directors, "When we read 'The Gulag Archipelago' in *samizdat*, we thought that if ever this book gets printed, everything will change, for ever." And then the unthinkable happened: the book was printed—and largely ignored. Russian liberals sneered at Solzhenitsyn, though none managed to offer anything comparable to his work.

Hard times for intellectuals

The country which had bloodlessly freed itself of communist ideology and had ended the cold war was experiencing a collective inferiority complex. The end of the Soviet Union did not produce anything resembling the artistic energy created by the Bolshevik Revolution in 1917 or the years that followed. Russian writers failed to fill a linguistic vacuum left by several decades of the devaluation of serious language. The country still lacks the words to describe the scale of events that have taken place over the past 20 years.

Ideological and economic collapse deprived Russia's intelligentsia of status, money and exclusivity. The very concept began to fall apart. "Capitalism was alien to the intelligentsia. Intelligentsia is a function of monarchy—normal bourgeois societies do not have it," says Sergei Kapitsa, a respected scientist. It was no surprise that most of Russia's intelligentsia did not recognise Yeltsin as one of "theirs". For many scientists, Yeltsin's were the "lost years".

Gary Neill



This may help to explain why a large part of Russia's scientific and artistic elite welcomed Mr Putin with open arms. Solzhenitsyn himself refused to receive an award from Yeltsin—whom he saw as a man who had humiliated Russia—but accepted one from Mr Putin, seeing in him a symbol of national resurgence (although he found many aspects of Putin's Russia unpalatable).

The Putin years have split the Russian intelligentsia. Dissidents and other sharp critics still exist in Russia today, but they have diverged from the country's cultural establishment, which does not see Mr Putin as alien to their interests. It is not just financial handouts that have made him attractive—although they have helped. The centralisation of the state with an added measure of nationalism has created a new sense of the return of status plus the flattery of the state's attention.

Mr Putin's unexpected visits to Moscow theatres and impromptu remarks on productions leave artistic directors, who once symbolised the intelligentsia, mesmerised. When a famous scientist received a medal from Mr Putin's hands he was astonished by how down-to-earth the former president was.

The Kremlin pays due attention to science and culture these days. Although it bashes non-governmental organisations, it has created a public chamber of approved and loyal members of the intelligentsia, which includes scientists, artists and lawyers. One of the first public appearances of Dmitry Medvedev as Russia's newly elected president was as a trustee of the Pushkin Museum of Fine Arts.

The sense of success and inclusion is harder to resist than the wrath of the state. Carrots are more corrupting than sticks. This phenomenon is powerfully described in Vasily Grossman's novel "Life and Fate" (1960). One of its central characters is Viktor, a talented physicist who stoically defends his science in the face of likely arrest, but becomes weak and submissive when Stalin calls him to wish him success. "Viktor had found the strength to renounce life itself—but now he seemed unable to refuse candies and cookies."

The adaptation of "Life and Fate" for the stage was put on recently by Mr Dodin in the Gulag town of Norilsk. When the powerful production came to Moscow it was played in a richly decorated new theatre built by a famous Russian actor who had signed a letter defending the shambolic and shameful trial of

Mikhail Khodorkovsky, an oil magnate who fell foul of the Kremlin. Unlike Mr Grossman's character, few people in the audience had experienced the burning shame of Viktor's choice. The moral qualities of the Soviet intelligentsia have always been exaggerated, says Mr Fortov. He says that scientists and artists happily informed on each other even when nobody demanded it. "They did so of their own volition." By the same token, nobody had made Mr Fortov sign the letter about Mr Khodorkovsky's trial or hang Mr Putin's portrait on his wall.

Russia still produces brave individuals, independent and conscientious enough to speak the truth to the state. But they remain individual voices. The murder of Anna Politkovskaya, an outspoken Russian journalist, raised a few sighs and lamentations—but not street protests. Her funeral, which produced a massive outpouring of sentiment in Europe, was a muted and depressing affair in Moscow. It did not bring journalists together, but exposed the gap between those who serve the state and those who serve the public. Mr Putin callously said at the time that Politkovskaya's work had minimal impact in Russia. Worse still, he was right. The country was almost deaf to her voice.

See no evil, speak no evil

Russia today is much freer than it was for most of the Soviet era. However undemocratic it may be, it is not a totalitarian state. The room for honest speaking is far greater than Russian intellectuals make use of. As Marietta Chudakova, a historian of Russian literature and courageous public figure, puts it, "Nobody has been commanded to lie down—and everyone is already on the ground." The media is suffocated by self-censorship more than by the Kremlin's pressure. Nikolai Svanidze, a Russian journalist who works for a state TV channel, admits: "There is no person who tells [me] what you can and what you can't do. It is in the air. If you know what is permitted and what is not, you're in the right place. If you don't, you are not."

Yet, as Russia struggles with corruption and abuse of state power, the need for a spiky intelligentsia is greater than ever. As Sergei Bulgakov wrote in 1909, "Russia cannot renew itself without renewing, among other things, its intelligentsia".

Energy supplies

The devil and the deep blue sea

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Finding more oil has become the first issue of the campaign

“IT IS just simply wrong for Congress to take a five-week paid vacation when so many families…are struggling under the weight of $4-a-gallon gasoline.” With those words Mike Pence, a Republican congressman from Indiana, explained to a crowd of bewildered tourists, including a troop of Boy Scouts, why he was refusing to leave the floor of the House of Representatives when its summer break began on August 1st, even though the lights, microphones and television cameras had been switched off. Instead, he and a few dozen Republican colleagues have returned to the chamber repeatedly in recent days to demand that Congress reconvene and vote on a proposal to increase the scope for oil-drilling in America’s territorial waters.

The Democrats have dismissed the “Phantom Session” as a gimmick. Nancy Pelosi, the speaker of the House, calls it “the war-dance of the handmaidens of the oil companies”. Even the White House has said there is no point recalling Congress, since the Democrats would continue to squelch the Republican initiative.

But the call for more drilling has captured the attention of the media and energised the Republicans, who have been searching for an issue to revive their foundering electoral prospects. Mr Pence, one blogger quipped, could not normally secure a prime-time interview on CNN “unless he hit Lindsay Lohan with a car”. Now drilling is dominating the airwaves, and the Democrats are on the defensive.

John McCain, the presumptive Republican presidential nominee and a supporter of offshore drilling, has ridiculed Barack Obama, his Democratic rival, for suggesting that Americans should try to conserve fuel by keeping their tyres fully inflated. Republican activists have taken to handing out pressure gauges labelled “Obama’s energy plan” at rallies. In response, Mr Obama has softened his opposition to offshore drilling, while denouncing Mr McCain as a lapdog of the oil industry who will do little to bring down prices.

Voters are certainly up in arms about the cost of oil. They rate the health of the economy as the biggest problem facing the country and the rising price of energy as the biggest drag on the economy, according to a poll that was conducted last month by the Pew Research Centre, a think-tank. Some 68% of respondents said that petrol (gasoline) was hard to afford. Among voters’ worries, the cost of driving easily eclipsed the war in Iraq, unemployment, health care or terrorism.

The Republicans argue that allowing oil firms more leeway to drill offshore will help to bring the price of

petrol down. Twelve years after an infamous spill from a well off Santa Barbara in 1969, Congress barred the government from issuing new offshore leases anywhere but in the western Gulf of Mexico and Alaska. By the government's own reckoning, there are some 18 billion barrels of oil to be discovered in the restricted areas—enough to supply all America's needs for two-and-a-half years. Oilmen also have their eyes on the Arctic National Wildlife Refuge, which lies just beside prolific fields on Alaska's North Slope, but there is less enthusiasm among Republicans for opening it to drilling; Mr McCain, for one, opposes the idea.

Moreover, there have been no big spills from offshore wells and platforms since 1969 (oil tankers, such as the *Exxon Valdez*, are another matter). Until recently, states whose beaches attract lots of tourists have supported the drilling ban. Florida, for example, has traditionally resisted oil exploration in the eastern Gulf of Mexico, for fear of another devastating spill. But congressmen hoping to lift the ban have tried to get round the objections of particular states by allowing them the final say on drilling close to shore, and by giving them a share of the royalties. A recent poll by Quinnipiac University found that 60% of Floridians now favour an expansion of drilling.

Democrats have tried to depict themselves not as enemies of drilling, but as the scourge of big oil firms. They dismiss the offshore ban as a distraction, since it would take a decade or so to get any oil out of the seabed and into cars (although that could be seen as a reason to hurry). They also argue, rightly, that the volumes of oil involved would probably be too small, and too expensive to extract, to make much difference to the price.

But the alternatives the Democrats are attempting to push through Congress are an incoherent mish-mash. One, dubbed "use-it-or-lose-it", would oblige oil firms to exploit their existing leases more quickly or see them revert to the government. The hitch is that federal leases already work along those lines, and few imagine that oil firms are deliberately ignoring vast pools of oil, given the current high price.

Another proposal involves revoking a tax break for oil firms, with the proceeds going to fund research into alternative energy. Mr Obama, in a similar vein, wants to impose a "windfall tax" on oil firms' profits and use the proceeds to give all taxpayers a $1,000 "energy rebate". But any measure that reduces oil firms' margins in America is likely to have the effect of diverting at least some investment to other countries—and so exacerbate the shortage of fuel produced at home.

Other proposals target speculators and the OPEC cartel. Yet another idea, to release some oil from America's Strategic Petroleum Reserve, would doubtless help to bring prices down briefly. But it would not be sustainable: the government's entire stockpile would keep America going for no more than a few weeks, and is supposed to be used only in dire emergencies. Democrats in either the House or the Senate have approved all these measures in some form, but the two chambers have been unable to agree on any of them.

The Republicans' plans are little more coherent. Mr McCain wants to suspend the federal government's relatively paltry tax on petrol during the summer months, when Americans tend to drive more. That would encourage drivers to buy more, pushing up prices again while reducing Uncle Sam's take. And both candidates want to reduce emissions of greenhouse gases—a sensible goal, but one that is likely to make energy more expensive, not cheaper.

Just before Congress shut up shop, a bipartisan group of ten senators suggested a compromise that would allow drilling off Florida, Georgia, the Carolinas and Virginia, while also raising taxes on oil firms. But amid the charged pre-election atmosphere, it is hard to see it becoming law. The Republicans are determined to make hay out of the Democrats' perceived intransigence on drilling, while the Democrats are keen to paint the Republicans as the lackeys of greedy oil barons.

Meanwhile petrol has been getting cheaper of late, thanks to the sliding price of oil. It still costs over $3.80 a gallon on average, $1 more than a year ago. But it is some 25 cents below its peak, and falling. Some Republican lawmakers, ludicrously, claim that the drop is a result of their drive for more drilling. Mere talk of opening up America's coastal waters, the theory runs, has convinced traders of a big future boost to oil supplies and so pushed the price down. In fact, the gyrations on the oil market illustrate the opposite: they show that the price of oil is largely out of America's politicians' hands.

Bioterrorism

A mystery unravelled

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From The Economist print edition

The facts behind America's first anthrax attack

A MONTH after the attacks of September 11th 2001, a letter arrived in the office of Patrick Leahy, a senator from Vermont. It read: "You cannot stop us. We have this anthrax. You die now. Are you afraid? Death to America. Death to Israel. Allah is great." Accompanying the note—one of at least five such letters sent to government and news offices—was a cache of the deadly powder that shut down Capitol Hill, killed five people and terrified an already shell-shocked country.

Al-Qaeda and Saddam Hussein topped the list of suspects shortly after the attack. They were easy villains. But nearly seven years later federal authorities believe the real perpetrator was Bruce Ivins, a long-time anthrax researcher at Fort Detrick in Maryland, who apparently committed suicide on July 29th, just as investigators were preparing to file charges against him.

Details have slowly leaked out since Mr Ivins's death. By sequencing the anthrax's genetic material, federal investigators say they matched it to a batch that Mr Ivins had charge of. In an affidavit that was unsealed on August 6th, one of the investigators claims that Mr Ivins had no good explanation for a spike in his night-time laboratory work around the time of the attacks, and that he told a co-worker he suffered from paranoid delusions that could affect his behaviour. Mr Ivins also apparently tried to foil investigators by giving them false samples of anthrax from his lab.

From that point the story becomes bizarre. Authorities say Mr Ivins had a "fascination" with Kappa Kappa Gamma, a sorority with offices near the mailbox where some of the anthrax letters were deposited. And his former therapist, who has her own lengthy police record, claims that Mr Ivins was planning to shoot up his lab as the feds closed in on him.

Still, some of Mr Ivins's colleagues have expressed doubt that he was the anthrax mailer. He would have had a hard time, they say, preparing the spores on his own and in secret. And what was the motive? Mr Ivins worked on an anthrax vaccine that was struggling to clear regulatory hurdles, and he may have sought to attract attention and money to his field. If that is so, he succeeded, but only up to a point.

The September attacks and the anthrax mailings resulted in a massive reshuffling of the federal bureaucracy, along with billions of dollars of new spending on homeland security and a heightened sense of threat that persists in America. But the country is still worryingly vulnerable to bio-terrorism.

The government's strategy to prevent such attacks relies chiefly on international non-proliferation agreements to keep stores of dangerous bugs secure. On the home front, it tries to keep track of which labs use, store or transfer certain dangerous materials. But an audit last October revealed that even the government's own bio-defence labs are inadequately monitored. And the anthrax case casts doubt on security-clearance procedures.

Biological agents are also becoming easier to make, so that a trained biologist with a relatively small amount of cash may soon engineer his own nasty bugs. Researchers have synthesised polio from scratch, and earlier this year a company in California created the first synthetic bacterium. At the same time, there are few tell-tale warning signs that someone has crossed the line from legitimate researcher to would-be bio-terrorist. Gerald Epstein, a homeland-security expert at the Centre for Strategic and International Studies, says that the researchers may simply have to learn how to police themselves.

Failing prevention, the government is trying to minimise the damage from a bio-terror attack. To detect dangerous bugs, air monitors have been installed in some 30 American cities. But authorities will probably rely on diagnoses in emergency rooms to decide whether to sound the alarm. And that may waste precious time.

The most impressive result of America's bio-defence effort is the massive Strategic National Stockpile of drugs, which will be distributed in the event of an attack. A report released last month boasts that, as of July 2007, the stockpile had enough smallpox vaccine to treat everyone in the country. It also held 10m doses of anthrax vaccine, with another 10m on the way. That takes care of some of the scariest bugs. But not all, and the stockpile cannot protect against biological agents authorities haven't seen or don't expect. Craig Vanderwagen, the assistant secretary for preparedness and response at the Department of Health and Human Services, says it would take about 16 weeks to create a vaccine if a new pandemic influenza strain appeared.

The government would then need to get the right drugs to the right people, and fast. Here, at least, the bio-security people are brimming with ideas. Some American cities are thinking of using mail carriers to dispense first-line medicines. There is even talk of simply pre-stocking American homes with powerful drugs, or of joint ventures with private companies used to complicated logistics, such as Wal-Mart, to distribute them.

The most heartening fact about bio-terrorism is that it is relatively rare. So far, terrorists have generally opted for simpler, more spectacular tactics, such as bombings. But as the anthrax case indicates, it takes only one individual who prefers anthrax spores to fireballs.

Military commissions

The driver’s tale

Aug 7th 2008 | NEW YORK
From The Economist print edition

A mixed first verdict from the military commissions

SALIM HAMDAN was Osama bin Laden’s driver. But was he a terrorist? Captured in Afghanistan and later transferred to Guantánamo, he has now become the first person to hear a verdict from the military commissions designed to try the detainees. On August 6th he was convicted of material support for terrorism but acquitted of conspiring to commit war crimes with al-Qaeda.

This mixed verdict suggests that these are not mere kangaroo courts. And it seems appropriate. Mr Hamdan was a foot-soldier who may well have had no access to al-Qaeda’s plans. But a navy officer testified that Mr Hamdan has pledged allegiance to Mr bin Laden, and professed his zeal for *jihad*. Even if he worked at a low level, he was probably a knowing cog in a terrorist machine.

The composition and procedures of the commissions have improved since they were first conceived by the Bush administration and subsequently ruled illegal by the Supreme Court in 2006. But the court that convicted Mr Hamdan was not allowed to hear the CIA mentioned at all, or allegations that he was interrogated brutally by CIA officers before his transfer to Guantánamo. Once there, human-rights groups say that he suffered sleep deprivation, harassment and inappropriate touching by a female guard. His lawyers argued that harsh treatment could render his confession that he had taken an oath of allegiance to Mr bin Laden unreliable.

The trial was held in the open, but key parts were secret. The decision rendering Mr Hamdan’s confession admissible in court was heavily redacted, so observers could not assess why the judge felt the confession was legally sound. Two defence witnesses were made to testify in secret. Mr Hamdan’s lawyers, though they had top-secret clearance, were given some evidence just before the trial, and other pieces as it proceeded.

Mr Hamdan faces life in prison, but his lawyers plan to appeal. If the fundamental fairness of the commissions comes into question it could derail the trials of bigger al-Qaeda fish to follow, some of whom face the death penalty. The biggest of them is Khalid Sheikh Mohammed, the self-described mastermind of the September 11th attacks, who has said he wishes for “martyrdom” at American hands. If he is put to death in a trial seen as flawed, he will get his wish.

One great brain v many small ones

The trouble with Friedman

Aug 7th 2008 | CHICAGO
From The Economist print edition

A doughty free-marketeer sparks controversy from the grave

EVERY big university has a scholar whose legacy lingers in hallways and classrooms, auditoriums and leafy quadrangles. At the University of Chicago no man looms larger than Milton Friedman, the Nobel laureate who led the “Chicago school” of economics and who died in 2006. When the university announced plans for a $200m economics institute in May, it seemed fitting that the centre should be named after him.

But a small war broke out. On June 6th more than 100 faculty members wrote to the university’s president to protest against the institute. Armed with academia’s common weapons, indignation and verbosity, they said they were all “disturbed by the ideological and disciplinary preference implied by the university’s massive support for the economic and political doctrines that have extended from Friedman’s work”, and pleaded for time for discussion. The university has ploughed ahead. The institute was launched in July, though the search for a director continues.

Friedman has always been controversial. For some academics, “A Monetary History of the United States”, which Friedman wrote with Anna Schwartz, is one of the most influential books of the 20th century. Others deride Friedman’s work in Pinochet’s Chile and his insistence on all-powerful free markets. (“If you put the federal government in charge of the Sahara desert,” Friedman once said, “in five years there’d be a shortage of sand.”)

“None of us deny that he was a major figure in economics,” explains Robert Kendrick, who signed the letter and is the head (on leave) of the music department. Rather, Mr Kendrick objects to what he sees as the institute’s ideological slant. Many fear that the university will be seen as intellectually homogenous. Susan Gzesh, who leads its human-rights programme, says that Latin Americans “don’t associate human rights with the University of Chicago; they associate it with Milton Friedman and the Chicago boys.” The institute, she says, may reinforce a monolithic view of the university.

Mark Hansen, the dean of social sciences, disagrees. This is not about advocacy, he says; “It is meant to be a research institute.” As for the university’s association with Friedman, many think–horrors of horrors—it is a good thing. Incidentally the Friedman institute will fill buildings now dedicated to God, a seminary at the heart of the campus.

A House race in Texas

The sweet spot

Aug 7th 2008 | SUGAR LAND
From The Economist print edition

Republicans are looking for redemption in Tom DeLay's old district

LAST month George Bush flew to Houston to raise money for a little-known congressional candidate. It was a private event, but a rogue attendee recorded his remarks. First the president analysed the trouble on Wall Street. "It got drunk and now it's got a hangover," he explained. Then he kidded around about foreclosures: "And then we got a housing issue, not in Houston, and evidently, not in Dallas, because Laura was over there trying to buy a house today."

The political headwinds favour Democrats this year, and they will probably increase their narrow majority in the House of Representatives. But Republicans have hopes for a handful of spots around the country. Chief among them is the 22nd District of Texas, a sprawling tangle of strip malls and subdivisions round Sugar Land, south of Houston. It is a conservative place; Mr Bush won almost two-thirds of its vote in 2004. Jokes about the housing crisis could kill a campaign in some parts of the country, but the regional economy is rollicking along in these fast-growing suburbs. So the Republican challenger, Pete Olson, is insulated from certain national trends. He even had a fund-raiser with the vice-president, Dick Cheney, in June.

AP



Olson and friend

Republicans think the seat is rightfully theirs. It was formerly held by Tom DeLay, a committed partisan who resigned in 2006 amid allegations of corruption and money-laundering. Confusion ensued, and a Democrat, Nick Lampson, won the seat later that year. But this was a bit of a fluke: Mr DeLay resigned after the primary, so Republicans could not replace him on the ballot. Despite that, the write-in Republican managed 42% of the vote to Mr Lampson's 52%. Mr Olson's campaign rests squarely on the idea that Mr Lampson does not share the district's values.

Local demography favours the Republicans, but the Democrats are determined to keep their trophy. One of Mr DeLay's most belligerent moves came in 2003, when he worked with the Texas legislature to push through a controversial redistricting plan that targeted all the state's "Anglo" Democratic representatives. Mr DeLay was then speaker of the House, and he seemed to think it unfair that there were so many Democrats in his state's congressional delegation. Mr Lampson used to represent the adjacent 9th District, but he lost this in 2004 after it was redrawn by Mr DeLay. The Democratic Congressional Campaign Committee now plans to spend more than $1m on Mr Lampson's behalf.

Richard Murray, a political scientist at the University of Houston, reckons that the Democrats have a good chance of holding on. Mr Lampson has been a vigorous advocate for NASA, which has its Johnson Space Centre at the eastern end of the district, and agrees with his conservative constituents on issues such as guns and offshore drilling. He has a better sense of local issues than his opponent, who moved to the district only last year; he vows to fight traffic, not terror. And although this is one of the few places in the country where Mr Bush is a campaign asset, Mr Lampson stands to benefit from a different set of coat-tails. In 2004 only 11,000 people voted in the Democratic presidential primary in the 22nd District's Fort Bend County. In 2008 that number jumped to 70,000. Barack Obama won by a two-to-one margin.

Expect a hard-fought battle. It is only one seat, but to either party it would be a prize. Voters are less impressed. A Sugar Land teacher reminisces that he once brought a whole stack of complaints to Mr DeLay's office and got no response. For him, symbolic values carry no weight; the candidate who most cares about his constituents is the one who should win.

The swing states: Colorado

Suburban cowboys

Aug 7th 2008 | DENVER
From The Economist print edition

How a reliably red state ended up in the purple camp

IN ONE episode of “South Park”, a potty-mouthed cartoon set in Colorado, a film festival comes to town. At first the locals are delighted. The visitors boost the economy and the films, which feature gay cowboys eating pudding, are better than expected. But the festival turns out to be a dastardly scheme, devised by Californians, to ruin pretty mountain towns and turn them into versions of Los Angeles. The natives must fight back.

This is pretty much how Coloradoans view their state. Not so long ago, the natives will tell you, it was a beautiful place filled with hardy individualists—“a leave-me-alone kind of state”, according to Jon Caldara of the conservative Independence Institute. It was also solidly Republican. Since the 1960s Colorado has voted for a Democratic president only once, in 1992, when Ross Perot and George Bush senior split the Republican vote. Then the Californians and other newcomers arrived, sprinkling their monstrous houses over the hills and upending the state’s politics.

These days Colorado’s Democrats are on a roll. Since 2004 they have taken control of the governor’s office, both chambers of the legislature and two congressional seats. John Hickenlooper, Denver’s Democratic mayor, is enormously popular across the state. In the caucuses on February 5th more people came out for Barack Obama, who carried the state, than for all the Republican candidates put together.

State statistics

Population, 2006

Colorado, % | National average, %

0 10 20 30 40

Black
Hispanic
Under 25
Veterans*
Blue-collar workers
Unemployment rate†

Colorado total, m	4.8

Household income‡, 2006, $

Colorado	52,015
National average	48,451

Poll ratings, %
Average June 9th to July 22nd 2008

40 41 42 43 44 45 46 47

Barack Obama
John McCain

Sources: Census Bureau; RealClearPolitics.com
*Of adult population †June 2008 ‡Median

This month the Democrats will hold a convention in Denver—the first time in 100 years that they have dared to meet anywhere near the Rocky mountains (see article). But John McCain is pushing back, assuring voters that he must carry Colorado if he is to win the White House. The polls are balanced, with most showing paper-thin leads for Mr Obama. A Senate race is similarly tight. Colorado may be worth just nine electoral college votes, but it is likely to be the hardest-fought state in the western half of America.

Colorado still projects a mountain-man image. Its five major-league sports teams are the Avalanche, the Broncos, the Nuggets, the Rapids and the Rockies. In reality, it resembles southern California even more closely than locals complain. Most of the state’s people live in a sprawling, more or less horizontal metropolis that stretches 130 miles (209km) from Fort Collins in the north to Colorado Springs in the state’s middle. In the central section, around Denver, the traffic can be almost as bad as in Los Angeles and the air often smells worse. Another similarity is that virtually all the population growth is in suburbs and small towns on the metropolitan fringe. This is where the Democrats are gaining ground.

Consider Larimer County, on the border with Wyoming. Once the sugar-beet capital of Colorado, this is now a booming job centre. Its biggest settlement is Fort Collins, a tidy town that was the model for parts of Disneyland. With its micro-breweries and coffee shops, Fort Collins is the kind of place that scores highly on magazine lists of the best places to live in America. It should be solidly Republican, and it is, but the party’s advantage is crumbling. In the past four years the Republicans have shed more than 2,000 registered voters in the county. The Democrats have added 5,500, while fully 9,000 new voters have registered as independent.

It is a similar story elsewhere. In suburban Arapahoe County, which both state parties describe as a battleground, the Republican edge in voter registrations has shrivelled from 29,000 to 7,000. Recently, independent voters passed Republicans to become the biggest group in the state. Some of this is due to Colorado's growing Hispanic population, some of it is due to Californians and some of it reflects the general unpopularity of the national Republican Party. But there is a more important reason for the Republicans' woes: their elected representatives are bonkers.



In the 1970s the state party came under the sway of an anti-tax, anti-big government group known as the "House crazies". This included Tom Tancredo, now a congressional scourge of illegal immigrants. The House crazies eventually joined forces with an equally fierce group of social conservatives rooted in Colorado Springs, headquarters of the evangelical Focus on the Family. By exploiting wedge issues and through clever use of ballot initiatives, they demolished both Democrats and moderates within their own party.

As the past four years have proved, Colorado's conservative machine can no longer generate election victories. But it has proved hard to retool, or even to shut down. More than one lawmaker has got into trouble for comparing homosexuality to bestiality. The small-government wing remains incensed that voters suspended a tax-restraining measure in 2005, even though it was crippling the state's finances. The Republican Party is in a worse mess, and has a more serious image problem, in Colorado than in America as a whole.

So Mr McCain's campaign will have to make most of the running. It starts with several advantages. Mr McCain is a westerner who understands local issues such as energy and water. His call for offshore oil drilling is going down well in a landlocked state where the cars are big and the commutes long. And his opponent has an important weakness. In order to keep his promise not to take money from lobbyists, Mr Obama must run a campaign independent of the state Democratic Party. This is a recipe for overlap and confusion.

Floyd Ciruli, a Denver pollster, points to another hazard. Thanks to Ward Connerly, a black political activist and yet another Californian, Colorado's voters will vote this November on an amendment that would ban preferential treatment on racial grounds—in other words, affirmative action. They are likely to approve it. Mr Obama, who supports affirmative action with reservations, may well end up on the wrong side of the argument. If so, his post-racial image will be tarnished.

Denver

Beer and snowballs

Aug 7th 2008 | DENVER
From The Economist print edition

Preparing to welcome the Democrats, at a price

THE last time Denver played host to the Democratic convention, it pulled out all the stops. A new auditorium was built. Brass bands greeted weary delegates as they arrived at the railway station. Snow was hauled in from the Rocky Mountains so that delegates could cool down with a summer snowball fight.

That was in 1908. This year will be even better—and greener. Delegates can cruise around on 1,000 bicycles. A fleet of convention cars will run on “waste-beer” ethanol provided by a local brewery. And the city centre will be covered with recycling bins and reusable water bottles. Organisers promise “an historic event”.

But Denver is having trouble paying for it. A 1974 law allows each party to receive $16.4m in public financing for its convention on condition that extra party funds will not be used. Including a $50m federal security grant, the total cost of the 2008 convention is well over $100m, of which Denver is contracted to raise $40.6m in private contributions. This does not include $15m-worth of “donated services” it must guarantee from corporations. The last official fundraising report was on June 16th, when the host committee missed a fundraising deadline, admitting it was $11m short.

The convention is awash with corporate cash. So far 80 corporations have given money in exchange for access to high-level politicians or exclusive promotional rights. If Barack Obama is forced to help raise money to make up the short fall, it could contradict campaign principles. Even more awkward, convention contributions are considered a tax-deductible business expense.

Party conventions were not always this expensive, nor did they rely so heavily on private financing. According to a report from the Campaign Finance Institute, in 1992 private donors spent $8m between the two parties’ conventions. Denver’s host committee must raise several times that, in a medium-sized city with few corporate headquarters.

All this, and the nominee is already known months in advance. A presidential candidate has not been chosen on the convention floor since Chicago in 1968. And as that convention proved, these events are not always harmonious. In fact, thousands are planning to barrack the event over the Democrats’ lacklustre attempts to end the war in Iraq. Denver is trying to keep protesters as far away from the convention as possible, and has invested millions in anti-riot equipment. Perhaps they would be better off staging another snowball fight.

Obama fatigue

Aug 7th 2008
From The Economist print edition

Is America beginning to weary of "Yes we can"?

Illustration by KAL



THE most politically potent emotion of the past 18 months has been Obamamania. This condition allowed a neophyte senator from Illinois to seize his party's nomination from the jaws of the formidable Clinton machine. The big question now hanging over American politics is whether Obamamania is giving way to Obama fatigue.

Mr Obama has everything going for him in the race for the White House. Almost 80% of Americans think that the country is heading in the wrong direction. People are disgruntled with George Bush's Republicans and worried sick about the economy. Mr Obama is also running a far better campaign than his rival—smooth and professional where the McCain campaign is slapdash and amateurish.

Yet the polls tell a different story. A Gallup/*USA Today* poll showed John McCain beating Mr Obama by 49% to 45% among likely voters. The cash-rich Obama campaign has been pouring money into the battleground states. But, if anything, the polls in those states are tightening. Generic Democrats enjoy a 10-15 point advantage over Republicans. But add the names Obama and McCain to the mix and you get a statistical tie.

This suggests that, for all their energy and professionalism, the Democrats may have made a big strategic error: allowing the election to become a referendum on their candidate rather than a verdict on the Bush years. This was probably inevitable if you run a mould-breaking candidate (in retrospect, the Democrats might have been better advised to run a white male rather than getting into a slugfest between a woman and a black). But Mr Obama is hardly a master of deflecting attention from himself.

The junior senator from Illinois is strikingly self-obsessed even by the standards of politicians. He has already written two autobiographies. He seems to be happiest as a politician addressing huge crowds of adoring fans. His convention speech at Denver was always going to be an extraordinary moment, given that he will be delivering it on the 45th anniversary of Martin Luther King's "I have a dream" speech. But Mr Obama decided to move it to a local sports stadium that has room for 75,000.

There are worrying signs, for the Democrats, that Obama fatigue is beginning to set in. A Pew poll this

week showed that 76% of respondents named Mr Obama as the candidate they had heard most about compared with 11% who named Mr McCain. But close to half (48%) of Pew's interviewees said that they had been hearing too much about Mr Obama—and 22% said that they have formed a less favourable opinion of him recently.

Mr Obama is undoubtedly an enormously talented public speaker. But his rhetorical tropes can begin to pall, particularly in a campaign that has already gone on for 18 months. How many more times can Americans hear the phrase "Yes we can" without wondering whether they really want to? George Will, a conservative columnist, notes that Disraeli's gibe about Gladstone might well apply to Mr Obama—he is "inebriated with the exuberance of his own verbosity".

Mr Obama may be ill-served by his hallelujah corner in the press. The Pew survey suggests that the frenzy of media coverage of Mr Obama is creating a backlash. He may also be ill-served by some of his more over-the-top supporters who treat him like a rock star rather than a statesman. "Barack Obama is inspiring us like a desert lover, a Washington Valentino," Lili Haydn wrote in the *Huffington Post*. "Couples all over America are making love again and shouting 'Yes we can' as they climax."

The McCain team has been quick to spot its opportunity. It has released a series of advertisements that are designed to pummel the president-in-waiting. One quotes an NBC reporter confessing that "it's almost hard to remain objective while covering Obama because the energy of the campaign is so infectious." Another compares him to Moses. Mr McCain also keeps saying that Mr Obama would rather lose a war in order to win a political campaign. This onslaught cleverly tries to turn Mr Obama's qualities—his youthful good looks and devoted supporters—into weaknesses. It also sends a clear message to voters: Mr McCain equals country first, Mr Obama equals Obama first.

Issues, not orgasms

This strategy is far from risk-free for Mr McCain. It threatens to dilute his brand as a straight-talking anti-Washington reformer. He has surrounded himself with veterans of the George Bush-Karl Rove machine: the man behind the latest ads, Steve Schmidt, was the person Mr Rove put in charge of the Bush war-room during the 2004 election. Mr McCain has also engaged in some decidedly unstraight talk. He has complained loudly that Mr Obama failed to visit wounded soldiers in Germany, ignoring the fact that his rival had visited injured troops in Iraq.

Mr McCain needs to win over undecided and independent voters if he is to have any chance of winning the White House. He also needs to come up with his own version of a "change" agenda for an electorate that is desperate for something new. But the more he employs Mr Bush's footsoldiers and borrows from Mr Rove's playbook, the more he opens himself up to the criticism that he is offering another four years of Mr Bush. The same polls that show the race narrowing also show that Mr McCain has not managed to break 46% in the Gallup tracking poll since Mr Obama won the nomination.

The Obama machine also remains formidable: it is impossible to wander around American cities these days without coming across enthusiastic young canvassers. But Mr Obama needs to reframe the election so that it is less about him and more about the issues. And he needs to abandon the rhetorical high ground for the nitty-gritty of policy. Otherwise the general election could prove to be the second coronation in a row, after Hillary's implosion, that has ended with a surprise.

Paraguay

The next leftist on the block

Aug 7th 2008 | ASUNCIÓN
From The Economist print edition

Measuring up Fernando Lugo's plans for a misgoverned country

Reuters



WHEN Alfredo Stroessner, South America's last dictator, was pushed out of office by a coup in 1989 it seemed that Paraguay had achieved a velvet revolution. It turned out to be made of velour. State terror and torture ended, and five tonnes of secret-police files documenting their practice appeared. But the Colorado Party, the creole fascist outfit that was the instrument of Stroessner's rule, remained in power. That will finally change on August 15th when Fernando Lugo, the victor of last April's presidential election, takes office. Almost two decades after Stroessner's fall, Paraguay's transition to democracy may at least mean something.

But it will not be easy for Mr Lugo. He is a former missionary who embraced a school of theology that blended Marx with St Peter. He spent more than ten years as bishop of San Pedro, one of the poorest regions of Paraguay, peopled by Guaraní Indian peasant farmers and landless labourers. He backed invasions of large rural estates by radical movements, becoming known as the "bishop of the poor".

He ran for president at the head of a coalition including the centrist Liberal Party and a dozen small far-left groups. Though he won handily, he got only 42% of the vote and he may not command a legislative majority. As a priest he was a radical, but as president he may have to be pragmatic. His choice of ministers was a balancing act, mixing centrists, leftists and reformers such as the finance minister, Dionisio Borda. He has said that he will not renew Paraguay's expiring agreement with the IMF; he also wants to attract private capital to state companies.

Mr Lugo has promised to improve health and education. The trickiest issue he faces is land, which remains the main source of wealth. Stroessner handed out vast tracts of state land to his cronies. Even by Latin American standards land ownership remains highly unequal. According to one guess, 1% of the population owns 77% of the farmland.

To complicate matters further, in recent decades Brazilians have bought up many smallholdings and

turned them into vast soya farms, which have become the mainstay of the economy and of government revenues. Land invasions have sometimes been met with violence: in the past three years, a dozen peasant leaders have been murdered by gunmen hired by landowners. Mr Lugo says he will carry out an agrarian census to find out who owns what. He has also called for patience, noting that the constitution guarantees private property but also the right of all Paraguayans to a piece of land.

Just where Mr Lugo will fit in the spectrum of Latin America's leftist presidents is not yet clear. His foreign minister, Alejandro Hamed, has expressed sympathy for Venezuela's Hugo Chávez. Mr Lugo himself has expressed admiration for Chile's Michelle Bachelet, a more moderate socialist. Under Mr Lugo, Paraguay may open diplomatic relations with China, ending its current link with Taiwan.

But it is Mr Lugo's relationship with Brazil that is likely to have the most impact on his presidency. The two countries share the Itaipu hydroelectric dam (still the world's largest until China's Three Gorges is completed). Paraguay uses less than a tenth of Itaipu's electricity; under a treaty, it sells the rest of its half share of the power to its neighbour at a price which is well below spot prices in Brazil. Mr Lugo said that he wants to renegotiate the treaty, but he has recently sounded more conciliatory.

He will also have to deal with the still-powerful Colorados. Membership of the party has long been a condition for obtaining a job in the public sector. Many government workers have professed their loyalty to the new president, presumably in the hope of keeping their jobs. But the party's leaders may make common cause with some of their past foes in smaller parties to try to thwart Mr Lugo.

Whatever the problems ahead, a successful handover of power will in itself be a novel achievement for Paraguay. So would sound and honest public administration. And there are some refreshing aspects to this priest-turned-politician. Unlike some of his peers elsewhere, he does not seem to see a new constitution as the road to earthly paradise, nor has he said he wants a second term before starting his first. He says that after five years in office he wants to return to working as a parish priest. Whether the Vatican, which only grudgingly accepted his resignation as a bishop, let alone the Paraguayan people, will allow him to is another matter.

Venezuela

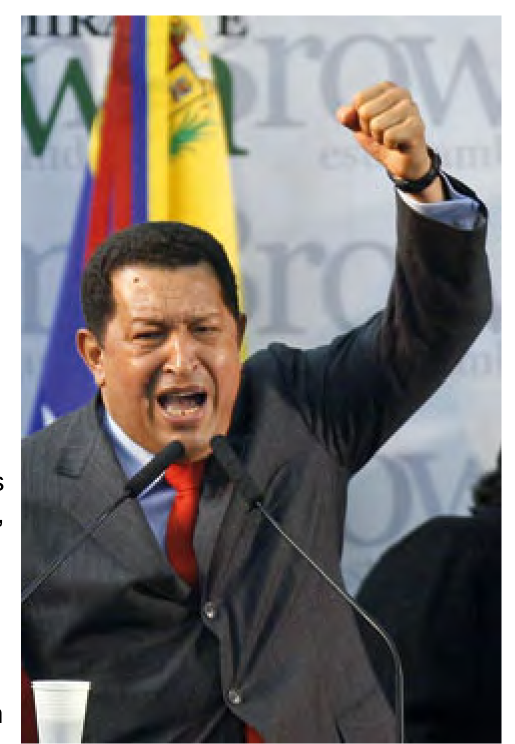
The autocrat of Caracas

Aug 7th 2008 | CARACAS
From The Economist print edition

Hugo Chávez tightens the state's grip on politics and the economy

Get article background

AFP



The man of many companies

FOR much of the past eight months, since suffering defeat in a referendum on changing the constitution, Hugo Chávez has seemed to be on the defensive. Abroad, he repaired strained relations with Colombia's president and with Spain's King Juan Carlos. At home, he backpedalled on unpopular measures, such as a new socialist educational curriculum and a draconian intelligence law. He met local businessmen in June and urged them to invest, in the hope that increased production would damp inflation of over 30%. But with Mr Chávez moderation rarely lasts, and he has now veered left again.

On July 31st he announced that the government would buy the country's third-biggest bank, Banco de Venezuela, owned by Spain's Grupo Santander. Days later, the government published 26 decrees, many of which mimic the constitutional changes rejected in the referendum. Some of them will further tighten the state's stranglehold on the economy.

This has been growing stronger since Mr Chávez won a second six-year term in an election in December 2006. Since then he has taken over the telecoms and electricity companies, as well as other businesses (see table). In June he told the local businessmen that he had no more nationalisations in mind.

Bolivarian business empire
Venezuelan nationalisations

Date announced	Company and industry	Amount paid, $bn
Jan 07	CANTV *(telecoms provider)*	1.3
	Electricidad de Caracas, CMS Energy *(electricity providers)*	1.0
Feb 07	BP, Chevron-Texaco, ConocoPhillips, ENI, Exxon-Mobil, Statoil, Total *(oil joint-ventures*)*	6.7
Mar 08	Lácteos Los Andes *(dairy producer)*	0.2
	Cealco *(cold storage and distribution)*	na
Apr 08	Lafarge*, Holcim and Cemex *(cement producers)*	na
May 08	SIDOR *(iron and steel works)*	1.7
Jul 08	Banco de Venezuela *(financial services)*	1.2-1.8

Source: Press reports *Local operations

But Banco de Venezuela was on offer: Santander was reportedly close to completing its sale to a local private bank. The first the bank's managers knew of Mr Chávez's intention to purchase was when he announced it on live television during a speech about education. Spain's government, which had hosted him in Madrid days previously, was also kept in the dark.

Bankers have done well from Mr Chávez's "Bolivarian Revolution". They have profited by arbitraging exchange controls, and from the government's penchant for issuing debt (despite its record oil revenues). But banks face increasingly onerous regulations. These set interest rates, and require around half of loans to go at subsidised rates to favoured purposes, such as farmers and housing. Alí Rodríguez, the new finance minister, has ordered banks to cut their holdings of some government paper, on which they are likely to make a loss. On top of all this, growth is slowing. "What is it that Banco Santander is seeing that makes it want to leave Venezuela when it is making so much profit?" asked José Manuel González, the president of the employers' confederation.

Mr Chávez has promised Santander a "friendly" deal. His oil wealth has allowed him to pay for the businesses he takes over, avoiding the friction that would be prompted by expropriation. As proliferating controls make doing business in Venezuela harder, more firms may fall into the government's lap. "I don't think this will be

the last bank to end up in state hands, and it's going to be happening in other sectors too," says Gustavo García of IESA, a business school.

The takeover of Banco de Venezuela will make the state the biggest banker in the country. The president wants to turn his new acquisition, which has a big branch network, into a "socialist bank", which will administer social security and welfare payments. This change of status may not be to the liking of the bank's workers. The government often obliges state employees to attend political rallies, and regularly sacks those who show signs of political dissent. Some 2m of the 6.5m Venezuelans with formal jobs are now employed by the state.

The decrees will further increase the state's powers, hobble opponents and limit the scope of private enterprise. Because the opposition boycotted the last legislative election, Mr Chávez's supporters dominate the National Assembly. Nevertheless, after his re-election he obtained the power to pass laws on his own for a period of 18 months. The latest crop of decrees were issued on the day before this power was to expire, in such a rush that their full texts were not published until later.

Under one decree a *chavista* militia will become a new branch of the armed forces. Another tightens state control over food production and distribution, threatening those accused of hoarding with up to ten years in jail. A third makes it easier for the government to take over private companies in general. Another creates powerful new regional officials. They will rival state governors, who are due to be chosen in November in an election in which the opposition hopes to dent Mr Chávez's near-monopoly of power.

Several of these measures violate the constitution of 1999, which Mr Chávez himself sponsored. "Here we have no constitution, no law and the president does exactly what he wants," Luis Miquilena, a former ally who broke with the president, told the *Wall Street Journal*. Mr Chávez says anyone who disagrees with the new laws should complain to the supreme court. But the court is beholden to the president. This week it upheld a decision by the auditor-general to ban hundreds of candidates from standing in the state and municipal elections for alleged corruption, even though none has been convicted by the courts. The main apparent target is Leopoldo López, the opposition mayor of Chacao, a district in the capital. Opinion polls had given him a strong chance of being elected as mayor of Caracas.

Those polls suggest that a small majority of Venezuelans still support Mr Chávez. But voters showed in the referendum eight months ago that they do not want his autocratic socialism. They may have to show him that once again.



Drugs in Canada

Needle match

Aug 7th 2008 | VANCOUVER
From The Economist print edition

Harm reduction, or abstinence?

BACK in 2003 many residents of Vancouver reckoned that an answer had finally been found to the worsening hard-drug problem in the liberal-minded city's Downtown Eastside district. A reformist city council, borrowing a European idea, opened the first supervised heroin-injection clinic in North America. It was set up as a research experiment, with a three-year remit (since twice extended). The idea was that giving addicts a safe place to inject themselves would remove them from crime, disease and other risks, and make them more amenable to treatment. The Liberals who were then running the federal government agreed, and blessed Insite, as the project is called, with C$1.5m (then worth $1.1m) and a vital exemption from drug laws.

Five years on, Insite has proved a disappointment to many in Vancouver. It has also become the object of partisan conflict. The Conservative federal government of Stephen Harper dislikes the project. A committee set up to advise it on the issue found that only about 500 of Vancouver's 8,000 addicts use Insite each day, and fewer than 10% of those use it for all their injections. It found no clear evidence of any increase in treatment, nor of any fall in HIV cases. It did estimate that the project might have saved one life per year but found that overdose deaths were still about 50 a year among addicts. Crime continues unabated as addicts steal to feed their habits, something which frustrates the local police. The government therefore proposed to allow Insite's legal exemption to lapse when it expired in June.

Many health workers thereupon sprang to Insite's defence. They are convinced that the project's "harm-reduction" approach can work. In May they gained an order from a justice of British Columbia's Supreme Court to stop the federal government from closing the clinic. In a radical ruling Justice Ian Pitfield found the federal law prohibiting the possession and trafficking of drugs to be unconstitutional and said that closing Insite would deny addicts access to a "health-care facility". Allowing the clinic to stay open, he gave the federal government a year to amend its anti-drug law. The federal government promptly appealed against the ruling.

Health care in Canada is a provincial matter. Last month Quebec stepped into the drug debate. Its public-health director announced that he was considering plans for supervised injection sites in Montreal and Quebec City. This seems to have made things even stickier for the federal health minister, Tony Clement.

This week Mr Clement restated his opposition to Insite. "Allowing and/or encouraging people to inject heroin into their veins is not harm reduction, it is the opposite," he said while attending an international conference on AIDS in Mexico City. He wants to focus instead on treatment and prevention. But he has remained silent as to whether the government would grant any request from Quebec for exemption from drug-prohibition laws. Mr Harper's hopes of turning his government's minority status into a majority at the next election depend on winning seats in Quebec. So the future of drug policy in Canada may turn on a political calculation.



The Amazon

Paying for the forest

Aug 7th 2008 | SÃO PAULO
From The Economist print edition

Donations welcome, even from foreigners

AP



Tapping the world's conscience

Get article background

IT IS an unusual prospectus for a new fund. Left-wing government (formerly hostile to private enterprise) seeks investment from governments or individuals to be managed by the national development bank. Returns will beat the market in terms of virtue only, though investors may lay claim to a part in the salvation of the planet. Norway, the most considerate of global citizens, has already pledged $100m. Others may follow.

The Amazon Fund, launched on July 31st by Brazil's president, Luiz Inácio Lula da Silva, leans on an idea that has become accepted wisdom among conservationists: to stop the Amazon rainforest from shrinking, a way must be found to make preserving it more lucrative than slashing and burning it. It is not yet clear who will be eligible for grants from the fund, but early indications are that it will give money to projects proposed by NGOs, scientists or by the governments of the states that are home to the forest. They might include supporting traditional rubber tappers and gatherers of Brazil nuts, or carefully managed forestry.

Brazilian officials have traditionally been suspicious of the involvement of outsiders in the Amazon, which comprises some 40% of the national territory. No sooner was the fund launched than both Lula and his minister for long-term planning, Roberto Mangabeira Unger, felt the need to insist that it did not represent a giveaway of Brazilian sovereignty, and that foreigners who gave money would have no influence on government policy. This seems a strange signal to send to potential investors. In practice some way to take account of donors' wishes will be found, according to Paulo Adário of Greenpeace, one of the NGOs that proposed such a fund a year ago. But the intended audience was at home.

Touchiness about the Amazon still runs deep. The generals who ruled Brazil in the 1960s and 1970s had a paranoid fear of an invasion of the Amazon. They built roads through the forest, and subsidised companies and people to colonise it. The army is still touchy on the subject. So, surprisingly, is Brazil's small (Maoist) Communist Party, which supports Lula but frets about foreign capitalists in the Amazon. However hedged about, Lula's embrace of the idea that the world as a whole has an interest in the Amazon is a sign of his country's increasing self-confidence.

Pakistan

More to worry about than Musharraf

Aug 7th 2008 | ISLAMABAD
From The Economist print edition

Amid growing insecurity and economic crisis, Pakistan's government decides to impeach the president

AP



PAKISTAN is sliding. Taliban commanders are taking over more of the country's ungoverned north-west by the day. From there they launch attacks into Afghanistan, killing NATO soldiers and countless Afghans. America, hitherto a remarkably forgiving ally, appears to think Pakistan's Inter-Services Intelligence (ISI) is assisting them. India certainly thinks so. Tensions between South Asia's nuclear-armed rivals are rising. After a suicide-bomb attack on the Indian embassy in Kabul last month—which India blamed on the ISI—its national security adviser, M.K. Narayanan, warned that India might have to "retaliate in kind".

The economy is hell-bound. Inflation is running at 25% a year. The stockmarket in Karachi has lost 35% of its value since April. During blackouts, Pakistani businessmen trade tales of capital flight. Foreign-exchange reserves—once emblematic of economic recovery—now barely cover three months of imports.

The government, a coalition led by the Pakistan People Party (PPP), has been paralysed since its formation in February. It has no plan for the north-west and appears to have given little thought to arresting the economy's decline.

Indeed, the government does not even have a permanent finance minister. He and half his colleagues were withdrawn from the cabinet in May by the PPP's biggest coalition partner, Nawaz Sharif's Pakistan Muslim League (N). It was protesting against the government's failure to reinstate 60 judges, who were sacked by Pervez Musharraf last November lest they object to his (apparently illegal) re-election as president. Mr Sharif trusts that, if reinstated, these judges would force Mr Musharraf to quit. For good measure, he has also demanded that parliament impeach the president. And he may have his way. After showdown talks on August 6th and 7th Mr Sharif and the PPP's leader, Asif Zardari, reached a provisional agreement to impeach the president and restore the judges.

Both moves would be popular. Having ruled Pakistan more or less outright for almost a decade, Mr Musharraf is blamed for many of its troubles. According to a poll for the International Republican Institute, an American NGO, 83% of Pakistanis want him out and the judges reinstated. Mr Sharif's principled stand on these issues—for so it is considered, despite the disregard he showed for the rule of law during his own two riotous spells in power—has boosted his ratings. He has also benefited from the absence of Benazir

Bhutto, Mr Zardari's charismatic wife, who was murdered in December. This left Mr Sharif, a champion of Punjab, Pakistan's most populous state, as the country's closest approximation to a national leader. The poll found that 82% of Pakistanis liked him—compared with 36% in 2006, when Mr Sharif was less popular than Ms Bhutto and Mr Musharraf.

Support for the PPP-led government, which came to power amid euphoria, has dived. Its few efforts at policymaking—including a doomed effort to put the army-run ISI into civilian hands— have mostly been hapless. Under Mr Zardari, the PPP seems rudderless and divided; a third of its elected members are said to be ready to rebel. Many Pakistanis considered his refusal to meet Mr Sharif's demands about the judges and President Musharraf as feckless. Having now apparently agreed to them, Mr Zardari might seem to have handed another victory to Mr Sharif.

It may not be so. Mr Zardari is no friend of Mr Musharraf or the army: he has accused the ISI of killing his wife. But he is wary of Mr Sharif's demands, for two reasons. First, he fears the restored judges would make trouble for him. For example, they might review an amnesty from corruption charges that Mr Musharraf gave to Mr Zardari and Ms Bhutto last year. In addition, Mr Zardari rightly considers that ousting Mr Musharraf would primarily help the PPP's historic and, no doubt, future rival, PML(N). In particular, the president's political allies in the Pakistan Muslim League (Q) party, would then be expected to rejoin Mr Sharif's party—whence Mr Musharraf plucked them, after he toppled Mr Sharif in a 1999 coup.

This may have tempted Mr Zardari to consider another strategy: let Mr Musharraf stay put; let the PML(N) quit the government; and let the president's men, of the PML(Q), join it instead. But this would make Mr Zardari even more unpopular. Mr Sharif would hope to benefit; but little good might this do him. He is currently barred from standing for election, having been convicted of crimes—including hijacking—in the aftermath of Mr Musharraf's coup. By acquiring some friendly judges, Mr Sharif may hope to overturn this ban. He will certainly not escape it if Mr Zardari sides with Mr Musharraf.

In short, Mr Sharif, like Mr Zardari, is reluctant to bring an end to an alliance for which he has no love. Indeed, in this week's negotiations, he made an important concession: he agreed to impeach Mr Musharraf before restoring the judges. A successful impeachment would require constitutional change, and therefore support from two-thirds of parliament. It is unclear that the government has this.

Reports of Mr Musharraf's impending exit—encouraged by the sporty president's decision to delay his departure to the Beijing Olympics on August 6th—may therefore be exaggerated. On the other hand, whether Mr Musharraf goes or not, it is certain that the government will continue wrangling. And at a time of national crises, this is an appalling prospect.

At least, as its budget deficit rises above 7%, Pakistan will have aid. On July 29th the US Senate's Foreign Relations Committee voted to triple America's non-military assistance, to $1.5 billion a year. Saudi Arabia is expected to defer payment on a $5.9 billion oil bill. But aid is not enough. After 18 months of political turmoil and worsening terrorism, Pakistan needs stability to restore the confidence of foreign investors. This will take a while.

From the Pushtun north-west, the news just gets worse. An unloved truce between the government and several Taliban commanders, including the most powerful, Baitullah Mehsud, has mostly broken down. In Swat, 250km (155 miles) from Islamabad, where a mini-*jihad* erupted last year, 150 people are reported to have been killed in a week's fighting between soldiers and militants. On August 5th a spokesmen for Mr Mehsud threatened to bring the *jihad* to Karachi, Pakistan's biggest city and home to many poor Pushtuns.

The army operates more or less freely on the frontier but is reluctant to touch Mr Mehsud. With a forbidding fief in the never-conquered tribal area of South Waziristan, a well-armed militia and suicide-bombers at his disposal, he is a daunting foe. He also holds about 100 soldiers and civil servants hostage. But the army's diffidence is increasingly being taken as evidence that, despite Mr Musharraf's protestations to the contrary, Pakistan never abandoned its policy of harbouring terrorists at home and sponsoring them abroad. Afghanistan and India maintain this. America, which is reported to have traced the Indian embassy bombing to the ISI, might be tempted to concur.

It hardly matters. America appears to have no option but to pour cash into Pakistan, and hope some good comes of it. Afghanistan will not be stable while Pakistan is in chaos. Foreign intervention would be unthinkable. America's Senate has recognised this. No doubt, so has the ISI.



WORLD
ASIA

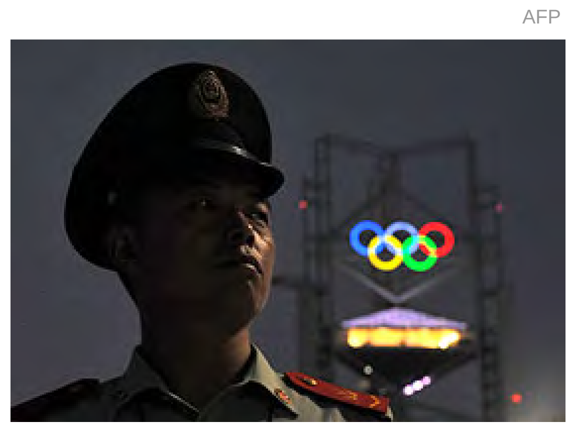
China

Swifter, higher, weaker

Aug 7th 2008 | BEIJING
From The Economist print edition

Behind the sporting glitz, anxieties about minorities and the economy

AFP



An enveloping gloom

CHINA'S Olympic pageantry is under way. Dozens of dignitaries, presidents and prime ministers have gathered in Beijing for an extravaganza that many Chinese see as a celebration of their nation's rise. But for all their professed joy at the spectacle, China's own leaders are fretful.

The massive security around Beijing and the authorities' strenuous efforts to keep potential protesters at bay is evidence of nervousness. These measures have gone beyond what might be expected for an event attended by so many bigwigs. In the past few months, instability has roiled Tibet and Tibetan-inhabited areas. Anti-Chinese resentment has been simmering in neighbouring Xinjiang too. Though sparsely populated, these regions make up around 40% of China's land mass.

On August 4th, four days before the start of the games, 16 policemen were killed in Kashgar in Xinjiang by two men suspected by the authorities of being Muslim separatists. It was one of the bloodiest attacks blamed on terrorists in recent years in China. Their weapons were crude: a lorry used to slam into the jogging officers, machetes and home-made explosives. Kashgar's party chief, Shi Dagang, said terrorists were "trying to turn 2008 into a year of mourning and a year of terror".

The threat of violence is probably being overstated by the authorities to justify suppressing any kind of peaceful protest during the games. Given the level of security in Beijing, few expect more than occasional small incidents. These are most likely to involve foreign supporters of various human-rights causes in China, particularly those relating to Tibetans, Xinjiang's Uighurs and religion. On August 6th two Americans and two British citizens raised banners calling for a "free Tibet" on poles close to the main stadium. They were ordered out of the country.

The state of the economy, though not yet as clear a challenge as that posed by restless minorities, is worrying China's leaders too. They have long been trying to prevent it from growing too fast, but now they fear that growth is slowing and may slow further. National income grew by 10.1% in the year to the second quarter, compared with 10.6% in the year to the first quarter and 11.2% to the last quarter of 2007 (see chart).

Exporters are anxious. Much of the fall results from a big decline in net exports. Reasons for this include an appreciating yuan, cuts in export-tax rebates and recession or slowdown in China's main export markets. Manufacturers of low value-added export goods such as clothes and textiles, which employ millions of workers, are

among the hardest hit. The state-controlled media have reported many closures of small and medium-sized businesses in coastal areas. Chinese leaders, previously more eager to nurture high-tech industries, toured textile factories last month in a show of political support.



Later in July, a meeting of the ruling Politburo signalled a policy shift. The formerly oft-repeated injunction to prevent overheating was dropped. Instead the leadership decided to focus on maintaining "steady and fast" economic growth, though it said it would continue its efforts to combat inflation.

Since the meeting there have been moves to placate exporters, such as easing controls on lending to small and medium businesses. Officials are relieved that the rise in the consumer-price index has slowed from a 12-year high of 8.7% in February to 7.1% in June, thanks partly to a decline in meat prices. But growth-boosting measures risk fuelling inflation. Wholesale prices are rising ominously fast, and big increases in state-controlled fuel prices have raised fears of worse to come.

Continued high growth would be good news for the middle classes—a constituency regarded by the party as vital to its grip on power. The past few months have been testing times for them. Contrary to widely held expectations that the stockmarket would keep on booming until the games, valuations have plummeted since their peak last October. A side-effect of this has been the shift of some small investors' money into other risky ventures. In early July the founder of a company involved in commodities-futures trading allegedly fled to America with millions of dollars of customers' money. Angry investors gathered at its headquarters in Beijing to the consternation of officials anxious to ensure a trouble-free Olympics.

There are growing worries too in some parts of China about the once seemingly irrepressible property market. Officials from the National Bureau of Statistics quoted by the state-controlled media this week said huge profits reaped by many in this sector over the past decade had come to an end. In Beijing residential apartments sales (measured by floor space) fell almost 50% in the first half of the year compared with the same period a year ago.

Chinese leaders can console themselves with the thought that the country as a whole is unlikely to suffer the problem endured by some previous Olympic hosts: a post-games downturn brought on by a sudden drop in investment and consumption. Beijing's economy accounts for less than 5% of China's GDP. But President Hu Jintao, at a rare press conference a week before the games, spoke of "greater challenges and problems" confronting China's economy as a result of global uncertainty. It has already begun to feel them.



WORLD
ASIA

The Beijing Olympics

Five-ring circus

Aug 7th 2008
From The Economist print edition

News from the Forbidden Citius, Altius, Fortius

YAO MING, a basketball player, carried the **Olympic torch** into Beijing's Tiananmen Square, starting the final leg of a relay that had begun in Greece on March 24th. On the eighth day of the eighth month, 2008 (supposedly, an auspicious date), the national teams enter the Olympic stadium ("the bird's nest"), though not, as usual, in alphabetical order. According to the head of the Australian Olympic committee, the order of the teams will be determined by the number of strokes in the first character of a country's Chinese name. That would put Guinea and Japan first, Australia and Zambia last.

Safety first

There is much grumbling in Beijing about **security measures,** including checkpoints circling the city, baggage searches on the underground and home visits by the police to check identity documents. The capital's secret police, the State Security Bureau, published notices calling on citizens to be on the alert for a host of potential threats, including people "using religion to threaten state security" and foreigners making contact with Chinese subversives. A resident quoted by a Chinese newspaper said this was the first time in 40 years of living in the capital he had seen such a notice.

But only fairly

Olympic officials said **air quality** in Beijing was "fairly good" on the eve of the games. The official reading of particulate matter in the atmosphere was 84 micrograms per cubic metre on August 6th. The BBC gave a reading of 292 micrograms. The level recommended by the World Health Organisation is 50.

No shows

Officials said 80-90 foreign dignitaries would attend the opening ceremony. They will not include the Polish and Czech leaders, who are boycotting it. Pakistan's **President Pervez Musharraf** delayed his visit, facing impeachment proceedings at home.

Missing the point?

"In sport, Chinese cultural values emphasise the spiritual not the material… **friendship and not competition**. This is completely the opposite of Western cultural attitudes to sport." *Studies on the Impact of the Olympic Games on Boosting China's International Status and Reputation*, China Legal Publishing House.

And separatist violence in Xinjiang?

"You should not fear religious people in your society." **George Bush**, speaking in South Korea on his way to the games.

Japanese politics

Round two

Aug 7th 2008 | TOKYO
From The Economist print edition

A new cabinet is torn between governing and preparing for the polls

Illustration by David Simonds



AFTER months of rumour and machination, Yasuo Fukuda, Japan's prime minister, finally reshuffled his cabinet on August 1st, replacing 13 of the 17 ministers. The new government brings in some heavyweights. But it faces irreconcilable goals. One is to push through reforms that require big political battles. The other is to polish the image of the Liberal Democratic Party (LDP) for a general election which must be called by September 2009.

The new government is split over these goals. The linchpin of the team is Taro Aso, a charismatic former foreign minister who becomes secretary-general of the LDP. He wants to splash money about. The economy may well be in recession: production, exports, wages and profits are all down. But Japan has the biggest debt-to-GDP ratio of any rich country (180% in 2007) and has promised that the budget will be in surplus by 2011, a test of probity. Mr Aso wonders aloud whether to push back that date.

But Mr Fukuda's new economic and finance ministers, Kaoru Yosano and Bunmei Ibuki, are fiscal hawks who want to stick to the target. Instead of spending more overall, they want to reallocate money that is now being wasted. Their target: the transport and construction ministry, home of pork-barrel spending. Its new minister, Sadakazu Tanigaki, is a former finance minister with the clout to prune the extravagance.

As Mr Fukuda tries to settle tensions within his team over spending plans, he must also prepare for a new session of the Diet (parliament). The going will not be easy. He has promised to set up a consumer-protection agency, improve health care and put receipts from the petroleum tax into the general account (where they can be used for anything) rather than keep them earmarked for road construction (ie, pork). He even wants to make permanent Japan's naval contribution to the international effort in Afghanistan—a controversial issue.

Mr Fukuda's plans seem politically shrewd. He hopes an economic-stimulus package will stave off criticism that he is insensitive to the plight of ordinary Japanese. Through his assorted policy proposals, he aims to steal the mantle of reform from the DPJ, which has its own leadership election in September. But it will all require deft handling. If he stumbles, Mr Aso is waiting in the wings.



The Philippines

Peace in our time, maybe

Aug 7th 2008 | BANGKOK
From The Economist print edition

A peace deal, at last, with Muslim rebels—then a backlash



A CHANCE to end a war that has raged for almost 40 years and killed 120,000 people has come, and perhaps gone. On August 5th the Philippines' government was set to sign a peace agreement with the largest Muslim separatist group on the southern island of Mindanao. The deal came after 11 years of on-off talks, brokered since 2001 by Malaysia. But the day before signing, as both sides' representatives and foreign dignitaries arrived in Kuala Lumpur for the ceremony, the Philippine Supreme Court halted it with a restraining order. Catholics from Mindanao had petitioned the court, and staged big street protests, because they had not been consulted on a deal which they fear could end up requiring some of them to live in a self-governing Muslim homeland.

In fairness, the peace agreement promises referendums in the affected districts. But even if the Supreme Court eventually lets it be signed, putting it into effect will almost certainly require changes to the constitution. President Gloria Macapagal Arroyo will probably be unable to achieve this, given the suspicions she raised in previous attempts at constitutional "reform", which looked to her opponents like ploys to keep herself in power beyond the end of her mandate in 2010. Some already allege that the deal is simply a cover for Mrs Arroyo to have another try at this.

Under the proposed agreement with the Moro Islamic Liberation Front (MILF), a semi-autonomous Muslim region covering parts of Mindanao and other nearby islands, which has existed since 1989, would be enlarged and granted expanded powers. These would include permission to conduct international trade negotiations and exploit its huge mineral reserves (a touchy, nationalistic subject in the Philippines). The agreement supposedly offers a definitive solution to the vexed question of how far the "ancestral domain" of southern Muslims extends. Islam's presence pre-dates Christianity by several hundred years in the Philippines.

The existing semi-autonomous region (see map) has been a poor advertisement for self-rule, its administration riddled with corruption and incompetence. It was created as part of an attempt to make peace with an older rebel group, the Moro National Liberation Front, from which the MILF had previously split.

These are but two of many armed factions in the region. Aided by American troops, and with co-operation from the MILF, the Philippines' armed forces have had some success in curbing Abu Sayyaf, a network of violent kidnap gangs espousing a jihadist ideology.

If the peace process with the MILF now collapses, its co-operation against Abu Sayyaf may end. It is also possible that many of the MILF's 12,000 fighters could abandon their ceasefire (some exchanged mortar rounds with troops this week). That said, for the MILF and all southern Muslims even an unsigned deal is a victory, since it amounts to acknowledgment by the national authorities of their right to greater self-government.

Elections for the existing regional body look likely to go ahead on August 11th in spite of all the uncertainties. Optimists might note that a peace agreement in Northern Ireland suffered years of setbacks before at last taking hold. But Mrs Arroyo failed to seek consensus among the broader public, Congress and indeed the armed forces before striking her audacious deal. Through this, and her remarkable knack of making people suspect her motives, she risks throwing away perhaps the best chance yet for ending the conflict.

North and South Korea

Shall we do lunch?

Aug 7th 2008 | SEOUL
From The Economist print edition

The phone in Pyongyang goes dead

AP



SOUTH KOREA'S president, Lee Myung-bak, may have an interesting lunch companion when he visits Beijing for the Olympics this week. North Korea's de facto head of state, Kim Yong-nam, could be sharing the table at the official lunch for visiting bigwigs.

The two men have much to talk about. Mr Lee recently offered an olive branch by dumping his earlier stance that the North's progress on denuclearisation should set the pace of relations between the two countries. But events have got in the way. The North has refused to co-operate with the South's investigation of the killing in July of a South Korean tourist, Park Wang-ja, by the North's army at Mount Kumgang, a northern resort. When the South stopped tourists from visiting the resort, the North threatened to take military action against the "slightest hostile act".

Behind this spat is an elaborate dance involving the two Koreas, nuclear weapons and America. Since Mr Lee's election last December, North Korea has kept up a steady drumbeat of insults and military manoeuvres. The anti-American beef protests that turned into anti-government demonstrations in the South further encouraged the North to be as awkward as possible (not that they usually need encouragement: their normal tactic is to be as shrill as possible until the other side caves in). South Korean security officials say that, for the first time in years, the two sides are not talking to each other even informally. The phone in Pyongyang has gone dead.

No doubt the North hopes to take advantage of domestic pressures on Mr Lee. Since signalling in a speech to parliament on the day of Ms Park's death that he wanted to resume a dialogue, he has come under attack even from his own conservative supporters, angered by the North's lack of remorse over Ms Park's death. The North's shrillness may also be an attempt to undermine the South as the North seeks a warming of relations with America as part of the talks over nuclear weapons. If so, the tactic seems not to be working. When George Bush stopped in Seoul on his way to the games he heaped praise on the South and called on the North to give up its nuclear weapons "or be the most sanctioned regime in the world".

North Korea is nothing if not opaque. In Beijing, where the Chinese hosts are eager for better relations between the Koreas, Mr Kim could boost the North's standing by the simple expedient of apologising to Mr Lee for Ms Park's death. But platitudes are more likely to be on the menu.

Tonga

Thy kingdom gone

Aug 7th 2008 | CANBERRA
From The Economist print edition

Tonga's king voluntarily surrenders power



UPON accession to the throne, Tonga's kings have traditionally retired to a position of revered remoteness, leaving day-to-day affairs of state to a designated *hau* or ruler. So it is to be with King George Tupou V, who was crowned King of Tonga on August 1st in an elaborate ceremony attended by minor royals from around the world. Since the death of his father, the crown prince has divested himself of interests in brewing, telecommunications and electricity. Now the monarch's political role is changing, too.

In 2006, demonstrations destroyed much of the business district of Tonga's capital, Nuku'alofa. The disturbances were sparked by "demagogues", the new king said, including "certain politicians who couldn't control the crowd". He was referring to pro-democracy members of parliament, many of whom are facing charges of sedition. Most of them swept back to power in an election in April. Elected members now make up nine of Tonga's 33 parliamentarians. Another 15 have been appointed by the king, and nine selected by the country's nobles.

Under new arrangements, scheduled to come into force for elections in 2010, the king will forfeit most of his powers of appointment and the number of "people's representatives" will increase to 17, or perhaps 21 if the king declines parliament's offer to allow him to continue to appoint four of its members. Parliament will choose the prime minister, who will pick his cabinet without monarchical interference. Although the king is likely to retain reserve powers, the lord chamberlain says he will act on the advice of the prime minister "in all matters of governance".

Pro-democracy parliamentarians are overjoyed. Their leader, 'Akilisi Pohiva, says the push for political change has come to an end. Tonga's nobles, however, are worried about being outnumbered in a popularly elected assembly and the royally appointed prime minister, Feleti Sevele, has been slow to embrace reform. A special commission appointed in July now faces the task of reconciling the politicians—sharply divided by the 2006 riots—and supervising what will be the most important election the Pacific state has witnessed.

Bangladesh

Sheikh Hasina's happy day

Aug 7th 2008 | DHAKA
From The Economist print edition

The shape of post-military politics begins to emerge

Get article background

IT HARDLY seemed like a significant event. On August 4th, just 1.5% of Bangladesh's voters were permitted by the army to go to the polls in the first round of local elections. The vote was held under a state of emergency. Candidates could not compete under party labels. One party leader was in jail, another in exile.

But these were also the first polls held since the army installed a civilian government in January 2007. Fears that the military would rig the result proved unfounded. The election commission purged 12m duplicate, deceased or bogus names from voter rolls. For the first time, Bangladeshis saw a voting system that seemed to deliver a fair and credible outcome.

In this case, the outcome was a decisive victory for candidates backed by the Awami League (candidates had to run as independents but could be supported by parties). It won 12 of 13 mayoral races. The League is led by Sheikh Hasina, a former prime minister who remains in exile in America following the government's decision to release her from prison in June on two months' medical parole. The day after the poll, the government extended Sheikh Hasina's bail for another month.

The vote made clear that the army has lost, or given up, the ability to influence the parliamentary election scheduled for December. That election now seems likely to go ahead (it was postponed last year), although the government refuses to set a date and the election commission took this week's polls as evidence that there was no need to lift the state of emergency. Talk of setting up a national security council, to formalise the army's role in politics after the vote, has not died down.

But three things make a return to civilian rule more likely. One is the confidence of the Awami League itself. Having been cut off from the public purse for 20 months, its politicians are desperate to get their mitts back on it again.

The next is a split in the League's main rival, the Bangladesh Nationalist Party (BNP), led by Khaleda Zia, the other "battling begum", who is in jail on corruption charges. Mrs Zia called on her party to boycott the local poll but the party has split in three. At least one faction, no less desperate to return to power than the Awami League, is likely to defy her call to boycott the general election, too.

The BNP is now trying to get the Awami League to join it in a movement against influential military figures, invoking 1990, when in a rare moment of harmony the battling begums united to oust the then dictator, Mohammad Ershad. Instead, the League has chosen to join hands with him, probably to keep him out of the BNP camp.

Third, the interim administration is running into problems. The army-backed technocrats who run the country are drifting, unable to take big decisions. Last week Tata, an Indian conglomerate, pulled the plug on a proposed $3 billion foreign investment, the largest ever in Bangladesh. The costs of uncertainty are speeding up the return of an elected government.

South Africa

A future of division, factionalism, stagnation and patronage

Aug 7th 2008 | JOHANNESBURG
From The Economist print edition

AFP



The African National Congress under Jacob Zuma shows signs of losing its way

Get article background

A LITTLE over half a year after Thabo Mbeki was ousted as president of the ruling African National Congress (ANC), worries are growing about the party's new leadership and where it may take South Africa after a general election due next year. Arguments still rage over the corruption charges facing the new leader, Jacob Zuma, who is likely to replace Mr Mbeki as the country's president. An unseemly fight within the ANC across the country is denting people's confidence in their rulers.

Mr Zuma appeared in court this week in a bid to have the charges against him dismissed. Other appeals will probably follow and his trial—if it happens at all—is unlikely to start before the election. Critics accuse Mr Zuma of delaying tactics, but hundreds of supporters, including ANC bigwigs and some cabinet ministers, went to the small town of Pietermaritzburg to support their champion. They want the charges dismissed on the grounds that he is the victim of a political conspiracy and that a fair trial has become impossible.

There are worries as to how far Mr Zuma's zealous supporters may go. The ANC's leader in the Free State province, re-elected last month, turned the party's provincial conference into a fund-raiser, with delegates urged to open their wallets to help pay Mr Zuma's legal bills. Some go much further than this. The new leader of the ANC Youth League, Julius Malema, created a storm when he bellowed at a rally in June that he was ready to "kill" for Mr Zuma. He later said that his words should not be taken literally, but refused to apologise for them. The row caught fire again when the secretary-general of the Congress of South African Trade Unions expressed his undying support for Mr Zuma by repeating Mr Malema's words.

The ANC itself, though professing its belief in democratic institutions, has failed to denounce Mr Malema's words publicly, beyond a statement from Kgalema Motlanthe, the party's deputy president, that they were "irresponsible". An unrepentant Mr Malema then declared that the opposition had to be "eliminated". Those who objected to his words were "political imbeciles" and "forces of counter-revolution", said the Youth League.

Quarrels are also swirling around the constitutional court. Last week it ruled against Mr Zuma in a case related to the charges he faces. Mr Zuma's supporters have openly questioned its judges' impartiality, an unprecedented slight against one of the country's most respected institutions. The court's judges had earlier accused John Hlophe, a controversial judge who presides over the high court in the Western Cape, of trying to lean on two members of the constitutional court to persuade them to rule in favour of Mr Zuma.

Gwede Mantashe, the ANC's secretary-general, lashed out at the constitutional court judges for going public with their accusations against Mr Hlophe before following the proper complaint procedures. Mr Mantashe saw it as a preparation for an onslaught on Mr Zuma. Whatever the outcome of the spat, the judiciary is damaged. One side insists that some judges are part of a witch hunt, while the other argues that the ANC is undermining judicial independence.

In any event, divisions inside the ANC since Mr Zuma's election as the party's national leader are as wide as ever—and are being replicated in local leadership contests. At the North West provincial conference in May, police had to disperse irate delegates claiming they were wrongfully excluded from the gathering. In the same province, some party members have taken the ANC to court. Others have been beaten up or shot.

In the Western Cape, the ANC's provincial secretary was stabbed in the neck at a party get-together. Countless other party meetings and nominations of candidates have been marred by intimidation and allegations of patronage and vote-buying. When the Youth League gathered to elect its leadership in April, the conference was suspended after some delegates got into drunken brawls, throwing chairs and exposing their bare bottoms to the media.

After decades of stitching up party elections behind closed doors, the ANC is finding it hard to become more open without rancour or greed. Mr Motlanthe warned a recent provincial conference in Limpopo that the party was in danger of following other liberation movements that lost their way after succumbing to “division, factionalism, stagnation and patronage”.

If this scramble for office and its spoils turns uglier, the ANC's popularity could dip. More importantly, it could damage South African democracy, since the ANC is likely to remain in power for a long time. Party bigwigs have been sent to problem provinces to discipline troublemakers. The new ANC leaders say that officials who perform badly will be replaced, a surprisingly novel idea in a party used to rewarding loyalty more than competence. Parliament, where the ANC has a big majority, seems to be keeping the executive in check more vigorously since Mr Zuma ousted Mr Mbeki as the party boss. But it is unclear whether this refreshing zeal will endure once the new guard takes charge, almost certainly with Mr Zuma as the country's president next year.

The ANC's new leaders say they want to make government work better to improve people's lives faster. They recently sacked two of the country's nine provincial premiers, both of them appointed by Mr Mbeki. One ran the worst-performing province, the Eastern Cape, long stained by dismal management, crumbling schools and hospitals, and allegations of corruption. The other, Ebrahim Rasool, was in charge of one of the best-performing provinces, the Western Cape, but had long been scrapping with the party's local bosses. The opposition Democratic Alliance could wrest the province from the ANC at the election if it manages to join forces with a flurry of smaller opposition parties, as it did to win control of the city of Cape Town. Still, there is little doubt that the ANC, as the party of liberation under Nelson Mandela and others, will retain a solid majority in the national Parliament.

Meanwhile, violent crime remains high, food and petrol prices have soared and power-cuts earlier this year dented people's confidence. The economy has slowed and higher interest rates are biting. There were strikes across the country on August 6th. The ANC's unedifying internal wrangles are only adding to South Africans' growing sense of gloom.

Mauritania

Another president booted out

Aug 7th 2008 | DAKAR
From The Economist print edition

Why the world likes this coup less than the last one



WHILE the rest of Africa seems to be slowly ridding itself of its penchant for coups, Mauritania seems to be perfecting its ability to stage them. Such is the country's current strike rate that the last two successful coups on the continent have both taken place in this Islamic republic, a vast, sandy country that sees itself as part of both the black and Arab parts of Africa. The latest victim is President Sidi Mohamed Ould Cheikh Abdallahi, who was arrested by his presidential guard and relieved of his duties on August 6th. Not a shot was fired and the news was spread mostly by the president's distraught daughter, who telephoned journalists as dissidents occupied their house and whisked her father away.

According to script, state television and radio went off air, except to declare Mr Abdallahi a "former" president and to reinstate the senior army officers whose sacking had been announced earlier that morning. The coup was led by Mohamed Ould Abdelaziz, the head of the presidential guard and one of the officers Mr Abdallahi had tried to fire. Even before the military dismissals, politics in Mauritania had been in a rotten state. In the space of three months one government had been sacked and another forced to resign. Complaints have ranged from poor management of rising food prices to the lack of transparency over the first lady's finances. The army was believed to have instigated a mass resignation of the president's supporters in parliament earlier this week.

Mr Abdelaziz was also a protagonist in the last coup, in 2005. After initial mutterings of disapproval, foreign countries on that occasion soon stopped complaining about the army's removal of President Maaouya Ould Sid'Ahmed Taya, who had ruled brutally for two decades. They were encouraged by the new junta's swift organising of the elections that brought Mr Abdallahi to power last year as the country's first democratically elected president since independence in 1960.

America sent some of its most senior diplomats to the inauguration. Donors spoke of fresh hope and started to sweeten their soured relationships with Mauritania. Some of the warmth derives from the country's value in the American-led "war on terror" in Africa. The new government proved a helpful ally. As if to bring the threat of terrorism into clearer focus, al-Qaeda has claimed several attacks in Mauritania over the past year. Western tourists have been killed and the famous Paris-to-Dakar rally cancelled.

Reactions to the latest coup have therefore been very different from the 2005 one. This time condemnation could not have come thicker or faster. America and the African Union have demanded the

immediate restoration of the president. Nigeria, the regional giant and a close ally of the United States, has refused to recognise the new leaders. The European Union said that aid could be suspended.

As noble as this may sound, the problem is that whatever foreigners say, the coup has some genuine support at home. People are sickened by the unproductive infighting of the politicians, seen by many as a pastime of the white Moorish elite, whose lust for clan squabbles is legendary. The president's former parliamentary allies say they are sad it came to a coup, but that this was better than staggering from crisis to crisis. The coup leaders have promised early elections. It remains to be seen how far the rest of the world is ready to go to reverse what has happened.

Rwanda

The blame game

Aug 7th 2008 | NAIROBI
From The Economist print edition

Exchanging unpleasantries about the genocide

AFP



Whose fault was it?

DID France expect—and indeed help—the genocide that killed almost a million people in Rwanda 14 years ago? That is the claim made in a 500-page report published in Rwanda this week, accusing 33 French politicians and army officers, including France’s then-president, François Mitterrand, of complicity. But the report must be read with a pinch of salt. It is in part the product of a feud between the two countries.

The report was commissioned by Paul Kagame, Rwanda’s president. Some will say it is a response to a French judge’s indictment of nine of Mr Kagame’s allies over the plane crash that killed his predecessor, Juvenal Habyarimana, whose death triggered the start of the massacres. But it is also part of a broader effort by Mr Kagame’s government to entrench its own narrative of the 100-day killing spree and refute revisionist histories that minimise the killings or, in some cases, deny that any genocide took place.

Most historians accept that Hutu extremists from Rwanda’s majority ethnic group organised the murder of 800,000 ethnic Tutsis and moderate Hutus with the backing of the former regime. Mr Kagame’s rebel Tutsi army toppled that regime and brought the killing to an end. Much of his government’s legitimacy derives from that achievement. One Western diplomat in Kigali, Rwanda’s capital, says that is why it is determined to document its version of events and fix it in the public mind. Mr Kagame argues that the genocide arose from the prevalence of a “genocide ideology”, and accuses those who distort the history of peddling the same ideology.

By indicting Mr Kagame’s allies over the plane crash that killed Habyarimana, the French judge, however, seemed to endorse a shocking claim by the genocide’s revisionist historians. This holds that Tutsi rebels shot down the aircraft deliberately to provoke massacres by Hutu extremists, which would in turn give Mr Kagame’s rebels an excuse to attack Kigali. The claim incenses Mr Kagame, who has long criticised

France’s ties to the former Hutu-dominated regime. That may explain the counter-allegation in this week’s report that France knew genocide was likely and helped it to happen. The French call these accusations “unacceptable”.

The history of the massacre remains tangled in controversy. Another claim is of a “double genocide”. This is based on accusations that Mr Kagame’s own forces committed atrocities during and after the genocide. Independent analysts view any implication of equivalence as preposterous, but the arguments, and the pain, will surely continue.

Israel

Gang warfare, in the courts

Aug 7th 2008 | JERUSALEM
From The Economist print edition

A politician hits back against a rampant judiciary

THEY are known collectively by their opponents as the “rule-of-law gang”, and for the moment they seem to be in the ascendancy. The gang is the collection of judges, prosecutors, policemen and journalists who last week forced the prime minister, Ehud Olmert, to announce his resignation over allegations of corruption. They wear their sobriquet with pride; the gang members see themselves as having been vindicated, yet again, in their crusade against graft and sleaze in high places.

After all, they argue, the fact that Mr Olmert was only the latest of Israel’s four most recent prime ministers to have been involved in criminal inquiries while in office shows how bad things have become. Binyamin Netanyahu (Likud, 1996-99) was questioned about an alleged votes-for-influence conspiracy. Ehud Barak (Labour, 1999-2001) was implicated in election-financing irregularities. And Mr Olmert’s predecessor, Ariel Sharon, was interrogated both about breaking such financing rules and about much more serious allegations of bribery and breach of trust. None of them was actually prosecuted (although Mr Sharon’s son was and subsequently went to prison). Mr Olmert probably will be prosecuted. Indeed, two of his former ministers are already in court: Avraham Hirschson, the finance minister, on charges of theft and fraud, and Tzachi Hanegbi, minister of the environment, who is alleged to have handed out government jobs to political cronies. Thanks in part to the diligence of the gang, that particular practice, long customary in Israeli politics, is being rooted out.

With Mr Olmert gone, the gang is now gunning for his minister of justice, Daniel Friedmann. He, however, will be a much tougher target. Not one for cash-stuffed envelopes and lavish hotel suites, the 72-year-old Mr Friedmann is a rumpled, soft-spoken law professor—who also happens to have a bee in his bonnet about the courts taking away the power of elected politicians. To this end, he has used his office to limit the ambit of the Supreme Court and has also introduced proposals to reduce the role of the attorney-general.

The gang, however, sees this as nothing less than a plot, nefarious or naive, to subvert the fight against corruption and sleaze; it is demanding that Mr Friedmann be left out of any post-Olmert coalition. Mr Friedmann and his supporters, on the other hand, who include several top lawyers and law professors, decry what they see as the all-too-frequent persecution of politicians for holding the wrong opinions rather than seriously breaking the law.

Mr Friedmann points, for example, to the fate of three of his predecessors who all planned to instigate the sorts of reforms that he is now attempting. The first was put on trial and acquitted, but by then had resigned his post. The second was interrogated by the police and his file left open for three years, so he could not take up the ministerial post promised to him by Mr Sharon. The third, Haim Ramon, a gifted Labour Party and now Kadima politician, had to leave the ministry last year when he was indicted for forcibly kissing a female soldier who worked in the cabinet office.

Mr Ramon was convicted (and has since returned to government, though not to the justice ministry), but Mr Friedmann sees in his case a possible turning of the tide against overzealous prosecutors. Mr Ramon’s defence team unearthed, belatedly, illicit wiretaps by the police and their illegal cover-up by the prosecution. Over the objections of the attorney-general, the state prosecutor and the police, Mr Friedmann got the government to direct the state comptroller, who is the national ombudsman, to open an inquiry into the case. This week Mr Ramon testified before the comptroller. Now, says Mr Friedmann, those bringing the prosecutions are themselves being held accountable.

Mr Friedmann’s opponents claim that he is not as high-minded as he makes out. They point to a long, failed fight to get his academic acolyte, Professor Nili Cohen, appointed to the Supreme Court; they claim that he resents the chief justice, Dorit Beinisch, for rejecting her.

Whatever the eventual fate of Mr Friedmann personally, the battle between him and his opponents exposes the deep and increasingly rancorous fissure within Israel's political and intellectual elite over the country's constitutional arrangements, and in particular the separation of powers. The increasingly dysfunctional political system, with its plethora of small parties, has led to unstable and weak coalition governments. That, in turn, has encouraged the passing of power from a weakened executive and discredited legislature to the much-respected judiciary. Mr Friedmann is accused of undermining that respect. He, however, argues that it has been fraying for years anyway, precisely because the Supreme Court strays too often into politics, sullying itself in controversies that it should not be involved in.



The Middle East and America's election

Who would be best for the Arabs?

Aug 7th 2008 | CAIRO
From The Economist print edition

Weighing up the relative merits of Barack Obama and John McCain

AFP



Schmoozing from the left...

SIX months ago, in a mock poll conducted at the US-Islamic World Forum, a gathering of influential Muslims and Americans held every year in the Gulf state of Qatar, Barack Obama won a resounding victory as the preferred choice for the next American president. If one is to believe internet chatter from America's extreme right, the Illinois senator's popularity among Muslims in the Middle East might be due to the allegations that he is 43.75% Arab by blood, or that he has been secretly funded by Arabs with ties to terrorism. Then again, it might just be natural that a candidate who has some Muslim ancestry, and who has protested against the widely loathed policies of the Bush administration, would inspire more enthusiasm than a Republican opponent committed to continuing those policies. Oddly enough, however, recent statistical and anecdotal evidence from the region shows that enthusiasm for Mr Obama is less fulsome than might be expected.

The lukewarm feelings partly reflect the burgeoning over the past eight years of a more general cynicism towards America. In a global opinion survey taken last spring regarding expectations from a new American president, results from five Muslim countries polled clashed with more optimistic opinions elsewhere; large majorities expected that American policies under any new administration would either not change much, or change for the worse. “Condoleezza Rice and Colin Powell were both black, and they still invaded Iraq,” scoffs a Cairo taxi driver.

From Tehran to Tunis, a common refrain in ordinary conversation is that somehow, by hook or by crook, powers within the American establishment “will not allow” Mr Obama to win, either because he is black, or because he has a Muslim middle name, or because he appears to have challenged the imperial ambitions of Washington's inner cabal.

They'll nobble him somehow

Among intellectuals, the widespread belief is that by election time in November the Democrat contender will, in any case, have been obliged to pander to interest groups, such as the mythically strong pro-Israel lobby, to the point where his foreign policies scarcely diverge from the incumbent's. Mr Obama's much-quoted speech before the America-Israel Public Affairs Committee in Washington in June, in which he endorsed a "united" Jerusalem as Israel's capital (a position his campaign later tempered), and his subsequent five-country tour in the region last month, only reinforced such doubts.

Reuters



...and schmoozing from the right

Much Arab press coverage focused on the fact that during his 36-hour stop in Israel, the candidate managed to spend barely an hour with Palestinian leaders. "You would need a microscope to locate the difference between the statements made by Obama during his recent trip to the region, especially in the Israeli-Palestinian part of the itinerary, and between the stances and policies currently pursued by the Bush administration," grumbled Elias Harfoush, a columnist for the liberal pan-Arab daily, *Al Hayat*. A spokesman for Hamas, the Palestinian Islamist party that seized control of the Gaza Strip last year, declared that the policies of Mr Obama and his rival, John McCain, appeared equally hostile. As recently as April, a leading Hamas official had said that he "liked" the Democrat, and hoped he would win.

Yet there remains a strong underlying desire, in a region that has come to despair of ever breaking its multiple deadlocks, that regime change in America could reverberate positively here. "Arabs are divided between a sceptical majority that sees no difference between John McCain and Barack Obama, and a hopeful minority that believes Obama could narrow the gap between the Muslim world and the West," says Marwan Bishara, the chief political analyst for al Jazeera, a popular satellite TV network.

Jihad al-Khazen, a seasoned editor at *Al Hayat*, suggests that the challenge from Mr Obama has already begun to influence American policy. Both Mr Bush and Mr McCain, he noted in a recent column, initially attacked the Democrat's call for dialogue with Iran as "appeasement", and his demand to withdraw American forces from Iraq as naive. Yet the Bush administration recently, and for the first time, dispatched a diplomat to join multi-party talks with Iran over its alleged nuclear weapon ambitions. Mr Bush has lately spoken of the need for a "time horizon" for America's engagement in Iraq.

Just as Muslims and Arabs might be expected to back Mr Obama, Jewish Israelis, ever concerned with security and anxious to avoid a lessening of superpower support, could be expected to favour Mr McCain's "staying the course" approach. Yet Mr Obama's careful reiteration of American orthodoxies regarding Israel has helped secure him not only overwhelming support among American Jews, but also improved his ratings in the Jewish state. A poll at the end of July put him barely 7 points behind Mr

McCain among Israeli Jews, compared with a 20-point gap in May. Perhaps more tellingly, as Israel enters its own election season unusually bereft of inspiring leaders, the same poll revealed that, among younger Israelis, it is Mr Obama who is strongly favoured to win.

Bavaria

Old soldiers march into the unknown

Aug 7th 2008 | WOLFRATSHAUSEN
From The Economist print edition

Germany's most traditional and successful state faces political upheaval

AP



IF AUSTRIANS were ever to storm over the Alps into Bavaria, they would have to reckon with the men of the *Gebirgsschützen*, the "Mountain Guards" descended from the local militias of the late Middle Ages who later fought the Swedes in the Thirty Years War of the 17th century. The old threats may have gone. But the members of the *Gebirgsschützen* (photographed above) still don traditional garb and weapons to shoot, sing and pray together, sustaining customs that make Bavaria the most distinctive of Germany's 16 *Länder*.

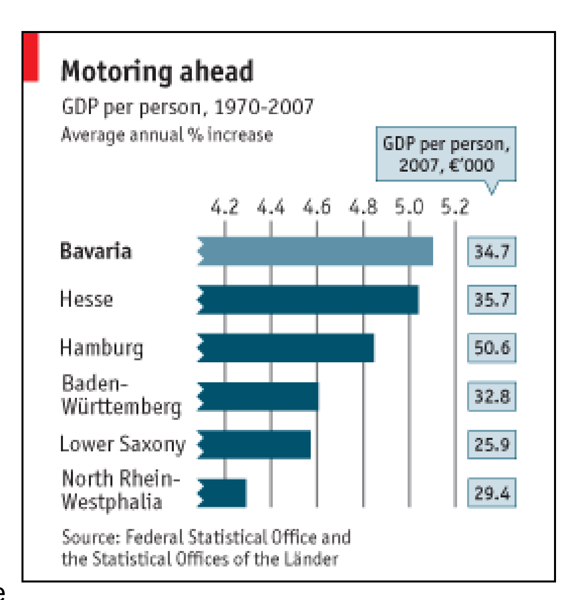
The role of the *Gebirgsschützen* is now to defend Bavarian culture, says Ewald Brückl, the captain of a company of mountain guards in Wolfratshausen, a community of about 17,000 south of Munich. That is no easy task. Munich's high technology and service companies draw migrants from across Germany; those who cannot afford the city's high prices settle in outlying towns like Wolfratshausen, the last stop on a commuter train line. One-third of Wolfratshausen's population turns over every six years, say local officials. That, and the indifference of the young, gnaws at Bavarian roots. Mr Brückl has a hard time recruiting young people, who, he grumbles, "have no interest in duty".

This is a worry not only for local-history buffs but for the Christian Social Union (CSU), which has governed Bavaria alone for 46 years, establishing what one scholar called "a political dominance unequalled by any other party" in post-war western Europe. Shrewd economic and social policies are part of the CSU's success. The CSU, moreover, established itself as the embodiment of a regional patriotism—stronger south than north of the Danube—that fuses Bavaria's thousand-year history with (mainly Catholic) Christianity and a sense that it is to be envied for its Alpine scenery and economic success. Bavaria styles itself a *Freistaat*, a "Free State", rather than a mere *Land*.

It has Germany's lowest unemployment rate, the lowest debt per head and a budget surplus. Since 1970, GDP per person in Bavaria has grown faster than in other western German states (see chart). Crime rates are well below the German average. In international tests of maths and reading, its schoolchildren outscore their peers from the rest of Germany.

The CSU is exceptional in part because Bavaria is exceptional. But the party's dominance may be in jeopardy in September's state elections. In recent opinion polls it has hovered at, and sometimes dropped below, the symbolically important 50%

mark. Some slippage is inevitable: the CSU won 61% of the state vote in 2003, when Bavarians registered their anger against an unpopular government in Berlin. But the CSU could be forced for the first time since the 1960s to govern Bavaria with a coalition partner. That would be “catastrophic”, says Alois Glück, the president of Bavaria’s legislature.



The shock would be felt nationwide. The CSU is the electoral partner of the Christian Democratic Union (CDU), the mainstream conservative party for the rest of Germany and the senior member of the national “grand coalition” government. Bavaria, with 15% of Germany’s population, supplied a quarter of conservatives’ overall votes in the last national election. A stumble by the CSU in September would be a bad omen for conservatives in the next parliamentary vote in September 2009. That is why at the CSU’s convention in Nuremberg in July the chancellor, Angela Merkel, reminded Bavarians how lucky they were. “Bavaria is where Germany wants to be,” she told the delegates.



Bavaria was not always so fortunate. Its largely agrarian economy missed the first stage of Germany’s *Wirtschaftswunder*, the post-war “economic miracle”, and absorbed some 2m ethnic German refugees from Czechoslovakia and Poland. But these burdens turned out in the end to be blessings too; Bavaria was not held back by industries destined to become uncompetitive, except in parts of Franconia, the Protestant north, which now lag behind the south. Refugees became entrepreneurs backed by government-guaranteed loans, the germ of later schemes to promote enterprise through credit.

By the late 1950s full employment elsewhere pushed German industry towards Bavaria’s beckoning arms. It used the federal aid to which it was entitled as a poor state to build roads and other things useful to business. It secured cheap and reliable energy, partly by building an oil pipeline from Italy and Germany’s first nuclear power plant. It was an early promoter of industrial “clusters” and realised that universities would be a draw (it is home to two of the best nine). Nine of the 30 companies whose shares comprise the DAX index have their headquarters in Bavaria, among them BMW, a carmaker.

The late Franz Josef Strauss, the CSU’s pugnacious chairman from 1961, who served as Bavaria’s premier for a decade, championed defence and aerospace (and helped found Airbus). Günther Beckstein, the current premier, says that he wants his state to be “one of the five most innovative regions in the world”.

The CSU did not get where it is by catering only to business. It befriended the common folk, who are more rural and, especially in Catholic “old Bavaria”, the state’s southern and eastern heartland, more conservative than the bulk of Germany’s working class. CSU governments blanketed the countryside with schools and lobbied for federal welfare spending; the party was traditional on family matters and tough on criminal ones. It is “unbelievably well networked” in Bavarian society, says Michael Weigl of the Ludwig Maximilian University in Munich. No town lacks a CSU office (which cannot be said of the opposition Social Democrats). It has links, often more of affinity than formal, to local football clubs, volunteer fire

departments and the *Gebirgsschützen* companies.

Now, though, the CSU is looking vulnerable. Last year it ousted Edmund Stoiber as state premier and party chief, fearing he would lead the party to defeat after nearly 15 years in power. The charismatic strongman yielded to an uninspiring duo: Mr Beckstein, a Franconian who is the first Protestant premier; and Erwin Huber, an old Bavarian, now party chairman.

The state government alienated innkeepers with Germany's toughest smoking ban. The state-owned Bayerische Landesbank lost €4 billion ($6.23 billion) in subprime punts. A plan to reduce from nine to eight the number of years pupils spend in Gymnasium, which prepares them for university, was poorly executed. Parents now suspect that Bavarian education is not as good as advertised; just a third of pupils make it to university, compared with more than half in North Rhine-Westphalia, the most populous state. In local elections in March the CSU's vote fell to 40%, its worst result in nearly 40 years.

The CSU has bounced back from scandals and setbacks before and may well do so again. It has already regained some support by demanding tax cuts aimed at the middle class in defiance of the chancellor. The Social Democrats, moreover, are in a state of internal turmoil (see article), and anti-CSU votes may be split among several other parties.

Yet victory would be a reprieve for the CSU, not a resolution. The party is changing, for example by accepting that working mothers need to park young children in crèches, but Bavaria is changing faster. An inspirational video screened at the party's convention—"Proud of Bavaria"—failed to show a single non-white face.

Partly thanks to Bavaria's economic success, the CSU's traditional demographic base of often rural Bavarians is losing importance. The state's growing ethnic and social diversity means that "it will be ever more difficult to get more than 50% of the vote", admits Mr Glück. The CSU helped modernise Bavaria; now it is stalked by modernity.

The feisty men of the *Gebirgsschützen* cannot defend it for ever.

Germany's Social Democrats

A dangerous flirtation

Aug 7th 2008 | FRANKFURT
From The Economist print edition

The SPD's growing troubles

AFP



Ypsilanti: linking with the Linke

ANDREA YPSILANTI, the soft-spoken leader of Hesse's Social Democrats, the SPD, is at the centre of a dispute that threatens to tear apart one side of Berlin's grand coalition. Against the wishes of her party's national leaders, the carworker's daughter and former Lufthansa stewardess is again flirting with the Left Party (the *Linke*)—a medley of East German communists, trade unionists and SPD malcontents—in the hope of leading a minority government in Hesse.

A related dispute involves Wolfgang Clement, once economic tsar to the former chancellor, Gerhard Schröder. In January Mr Clement warned voters in Hesse to think twice about supporting Ms Ypsilanti because of her unrealistic energy policy. This was doubly enraging because Mr Clement sits on the board of RWE Power, a company with interests in unpopular nuclear energy. A party tribunal in North Rhine-Westphalia last month ordered his expulsion unless he apologises and promises not to warn off voters again. Mr Clement has refused.

These rows have reopened fissures that have long threatened to split right-wing reformists from the SPD rank-and-file. The latter's discontent has been aggravated by rising living costs and fears of joblessness as the German economy falters. The SPD's popularity has dived from 34% at the last election to nearly 20% in some polls. Party membership has for the first time been outstripped by the conservative CDU. The SPD's disarray, including limp leadership, threatens to lose it more support.

This week in Hesse Ms Ypsilanti began fresh overtures to the Left Party, which is regarded as beyond the pale by the federal SPD leaders. They fear that giving it a say in policymaking in Hesse is likely to lose the SPD more centrist votes, not least in next month's election in Bavaria.

Yet Ms Ypsilanti is not for turning. In March she was thwarted from forming a similar coalition by a single rebel from her parliamentary group. This time she thinks she has got her sums right: 42 SPD parliamentarians (minus the rebel), nine Greens plus the external support of six *Linke* would give her a majority of just one in the Wiesbaden parliament. But it may prove a pyrrhic victory.

Italy

The thin green line

Aug 7th 2008 | ROME
From The Economist print edition

Italy gets tough on street crime. But it's still lenient about corruption

AP



Medellin on the Mediterranean

GUNNERS secured Milan's Piazza del Duomo; paratroops took up position outside St John Lateran in Rome; and Alpine mountain troops in feathered headgear helped police raid a drug-pushers' open-air hangout in Turin.

Italy is hardly Colombia. There is not even a warning of imminent terrorist attack. So why this air of national emergency? The government of Silvio Berlusconi, Italy's prime minister, ordered the army on to the streets on August 4th to quell what it says is a crisis in law and order.

Three thousand soldiers will be employed on public-order duties. Most will be replacing police on guard at immigrant detention centres and near potential terrorist targets like embassies. About 1,000 will patrol alongside the police. The government says they will stay on the streets for at least six months.

A timely study by Censis, a research institute, casts some doubt on the government's premise that crime is running out of control. In 2006 there were fewer murders in Italy than in Germany, France or Britain; one is more likely to be killed in Brussels than in Rome.

Murder rates are not the same as crime rates, however. Government figures show that the total number of offences has been rising by 6-7% annually. What seems to have risen faster is public anxiety. Another survey, for an insurance company foundation, Unipolis, published on July 27th, found that Italians saw crime as the main cause of insecurity, and almost half connected lawbreaking with foreigners.

The government attributes its election victory in April to Mr Berlusconi's pledge to get tough on crime. Putting troops on the streets sends a message to his voters that it intends to deliver on that pledge. Anecdotal evidence suggests that most Italians find the troops' presence reassuring.

Whether they will help stem crime is another matter. General Mario Buscemi, who led the last deployment of the army in Italian towns, to tackle the Mafia in the 1990s, recalled that he had 20,000 men just for Sicily. The current operation, he said, was "substantially symbolic". The soldiers do not have powers of arrest, nor are they properly trained or equipped for policing operations.

One widely voiced fear is that the sight of troops could scare off tourists. The mayor of Rome, Gianni Alemanno, a member of Mr Berlusconi's Freedom People movement, has fought a running battle to keep

uniformed soldiers out of the city centre. Italy may not be Colombia, but it might start to look like it.

Amid the melodrama—including the “emergency” over the arrival of migrants on boats from north Africa and the eviction of gypsies—there is a nagging question. Why is a government so tough on crime so indulgent about corruption?

Among Mr Berlusconi’s first acts in government were closing the office of the high commissioner against corruption and passing a law that means he himself will not have to answer to bribery charges.

The Caucasus

Bang bang, who's dead?

Aug 7th 2008
From The Economist print edition

Sabre-rattling continues in a dangerous corner of Europe



IF IT is not the prelude to a real war, it risks being mistaken for one—and in a corner of Europe where Western and Russian interests could clash nastily. The talk of war has been in the air for months. But in the past two weeks six people have been killed in the breakaway (and Russian-backed) region of South Ossetia.

Claim and counterclaim abound. Russia says that Georgia fired first and is reinforcing its forces as a prelude to war. It sent warplanes into Georgian airspace last month—to deter an attack, it said. It also blames Georgian warplanes for violating South Ossetian airspace. Georgia says this is disinformation: Russia and its South Ossetian allies "are trying to create an alternative reality", says a spokesman. Georgia has brought foreign ambassadors to inspect its lightly armed guard posts which, it insists, fire only in self-defence. This is by no means the first skirmish in the region. Georgian and South Ossetian politicians wrangled about a possible meeting on August 7th aimed at calming the mood.

But the row has given Russia a chance to step up pressure on Georgia, portrayed in the Russian media as a tiresome and aggressive Western stooge. The South Ossetian leader, Eduard Kokoity, said that he would force Georgian forces out of his self-declared republic (which is a patchwork of villages and small towns, some controlled by Georgian authorities and others by separatists). He says 300 Russian irregulars have come to his aid.

The quarrel in South Ossetia follows an escalation of tension in the other breakaway region of Georgia, Abkhazia. Russia has reinforced its military presence there, which is nominally part of a UN-monitored peacekeeping effort. A German-drafted peace plan for the economic revival of Abkhazia, indefinite autonomy and the return of Georgian refugees has so far stalled. The Abkhaz authorities are uneasy about the Russian embrace, but fear the return of ethnic Georgian refugees, once the largest ethnic group in the region.

The Kremlin's immediate aim seems to be to force Georgia to return to the Joint Control Commission in South Ossetia. This body comprises Georgia, Russia, South Ossetia and the Russian republic of North Ossetia, just across the border, with the Organisation for Security and Co-operation in Europe (OSCE), a Vienna-based multilateral body, as an observer. Georgia thinks that this is intolerably unbalanced and has walked out.

Russia also wants Georgia to give a formal guarantee that it will not use force in either breakaway region. Georgia thinks that unless its refugees can return this would amount to de facto recognition of the

secessionists. It wants a stronger OSCE presence, demilitarisation, and international (not Russian) peacekeepers. It also wants joint Georgian-Russian control of the Roki tunnel under the Caucasus mountains. This, Georgia says, is used both for smuggling and for illegal reinforcements to South Ossetia.

Russia's broader aim may be to try to roll back the advance of pro-Western forces in its "near abroad" by highlighting the West's inability to help Georgia. The hotting up of Georgia's conflicts coincided with Kosovo's declaration of independence, recognised by much of the West, and American pressure for the expansion of NATO to Georgia and Ukraine.

That move has been stymied, mainly by Germany; Georgia was promised eventual NATO membership but no firm plan. Though Georgia has become a vital corridor for oil and gas exports to Europe, this has not brought the support that its leaders had expected. A lame-duck American administration has been able to do little, though Georgians hope a presidential-election victory by John McCain, an ardent supporter, may change their fortunes. The country's strong-willed and idiosyncratic president, Mikheil Saakashvili, is not seen by all European leaders as quite the paragon of legality, freedom and reform that he claims to be. Georgia's image was severely dented in November last year by a crackdown against the opposition.

Georgia is in a quandary: its Western friends tell it to stay calm yet seem unable to stop Russian bullying. It is all too easy to imagine misjudgements on either side leading to a real war. Georgian officials will spend August nervously at their desks. Some of their European counterparts may have other plans. As the recipients of an often daily blizzard of alarms and appeals from Georgia, they think that a summer break might be just the ticket.

Turkey

After the storm

Aug 7th 2008 | ANKARA
From The Economist print edition

The avoidance of a political collision has helped economic confidence. But without reform, it may be short lived

WHEN Turkey's constitutional court stepped back from a threat to ban the ruling Justice and Development (AK) Party last month, businesspeople had more reasons than most to raise a cheer. The treasury's borrowing rates promptly fell and the main stockmarket index rose by about 2%. Standard & Poor's, the international credit-rating agency, revised its outlook for Turkey from "negative" to "stable".

Mehmet Simsek, the outspoken economy minister, said in July that the crisis had cost the treasury $16 billion in higher interest payments since March, when the state prosecutor's lawsuit against AK rattled the bond markets. The prosecutor accused the government of trying to introduce elements of Islamic law in defiance of the state's secularist constitution. He wanted the AK disbanded and leading figures banned from political activity for five years, among them the president, Abdullah Gul, and the prime minister, Recep Tayyip Erdogan. In the event, the court decided by a narrow margin not to ban AK or its leaders, but instead imposed a hefty fine for anti-secular activity.

The global credit crunch and rising oil prices have hurt emerging markets; Turkey's big current-account deficit makes it more vulnerable than most. "It's been a difficult year," said Mr Simsek in an interview. "But not a lost one." Even as AK locked horns with the meddlesome generals, it managed to push through a raft of reforms which Mr Simsek says "should fix Turkey's structural problems". These include overhauling a bankrupt social-security system (some $30 billion is needed to plug this year's gap), easing taxes on employers and reforming the energy sector.

There is more good news for foreign investors. After months of hesitation, Turkey is prepared to rejig a $10 billion loan agreement with the IMF that expired in May. "We are in the process of technical negotiations on a potential precautionary standby arrangement," confirms Mr Simsek. Translation: the IMF will continue its scrutiny of the economy, which will reassure investors, and put aside more money for Turkey's possible use.

Mr Simsek is the first to admit that recent reforms are not as tough as they should be. For instance Turkish women can still retire at 43, and men at 47. The newly adopted retirement age, 65, does not become effective until 2048. That is because the constitutional court struck down the government's attempt to introduce it sooner, saying "the rights of civil servants cannot be taken away".

The immediate political danger may have passed, but there is no certainty that AK's pro-secular foes will remain quiet indefinitely. All eyes are on the former land-forces commander, General Ilker Basbug, who became the chief of the general staff this week. Taciturn and aloof, the new army chief is an old-style secularist, but with a twist. He is said to welcome new ideas and understands that the festering Kurdish insurgency, which Turkey says has cost it $120 billion since it began in 1984, cannot be solved through force alone.

In a hopeful sign, the Supreme Military Council that appointed General Basbug has for the first time in 16 years declined to boot out any officers for alleged anti-secular mischief, as is customary every year. Lale Sariibrahimoglu, a defence expert, suggests that this may well be an olive branch from the generals.

A bigger risk to the economy may be the government itself. Mr Erdogan, feeling vindicated, may yet persist in provoking the secularists, as he did with his ill-fated attempt to lift the ban on the Islamic-style headscarf in universities. Ominously, a row between President Gul and the country's assiduously pro-secular academics is brewing after the president ignored Istanbul Technical University's choice for a new rector and picked another (presumably less stridently anti-Islamist) man instead.

Some people worry about the local elections to be held in March. AK's assertion that this time round it will capture Izmir and Diyarbakir, the only big cities run by pro-secularists and Kurds respectively, has not

helped. Many suspect that the government's drift towards economic populism—it recently unveiled a $12 billion investment package for the poor and largely Kurdish south-eastern provinces just as the central bank is trying to keep inflation in single digits—may be electoral tactics.

The business community's main concern, however, is not that the government will become over-confident. Rather, it is that a chastened government may abandon reforms to placate its enemies. "Striking the right balance between courage and caution", says an Istanbul-based banker, "remains the greatest challenge of all."

The other Olympics

Passing the baton

Aug 7th 2008
From The Economist print edition

As the Beijing games get under way, London prepares to play host in 2012. The economic downturn will make the next lap hard going

Anthony Charlton



SKELETONS, unexploded bombs and a noxious smell greet visitors to the site in east London that will host the Olympic games four years from now. The site, which takes up about one square mile, once housed chemical factories, gasworks and other mucky industries; centuries-worth of reeking goo are now being removed from the soil by gigantic washing machines. Archaeologists have discovered Iron Age skeletons deeper down (under the Olympic swimming pools) and suspect the Knights Templar ran a water mill somewhere near the proposed velodrome.

The awkwardness of the site, which 52 pylons, now buried, once criss-crossed, and the poverty of its surroundings were central to the appeal of getting the games for London. As well as generating national pride, the government was anxious to jazz up a poverty-stricken bit of the capital. “It was partly an emotional decision. When you take the Tube out there, life expectancy drops at every stop as you go further east,” says a former aide to Tony Blair, the prime minister who approved the deal.

Mr Blair’s successor, Gordon Brown, never saw it so rosily, and he can be no keener now. Work on the park is going well: in June the International Olympic Committee said progress was among the best they had seen. Polls suggest the public remains cheerful. But the bottom line is dire: the initial public-sector budget of £3.4 billion ($6.6 billion, at today’s rates) was raised in March 2007 to £9.3 billion after security and tax considerations, plus a dash of realism, caused projected costs to soar.

Now, tougher economic times threaten even that budget, and could mar plans for what was to have been a glorious Olympic legacy. The highest-profile casualty of tighter credit conditions is the Olympic Village which, with room for 17,000 athletes (and, after the games, 3,500 new homes), is the site’s largest and most expensive project. Lend Lease, its Australian builder, is in talks with the government’s Olympic Delivery Authority (ODA), having failed to raise the cash privately; a new deal is planned by Christmas. David Higgins, the head of the ODA, says it “inevitably means pain being shared by all parties”. Any extra public support will come out of the £2.7 billion contingency fund built into the new budget. The fund may be raided again: Mr Higgins says some other contractors are struggling to raise finance too.

On other projects, a lack of competition for contracts has inflated costs. Auditors reported in June that

almost a quarter of the main procurement that the ODA had contracted for by the end of March had attracted no more than two bids. The main athletics stadium and the aquatics centre received only one serious bid each. Both are now well over budget, with the fees of the sole bidder in each case "at the upper end" of what the ODA had expected.

Public bodies may be left even more out of pocket if receipts from the sale of land and buildings after the games are lower than expected. Last year the mayor's office reckoned London could sell its share of the Olympic Park for £838m, assuming that house prices would rise by 6% each year. That now seems optimistic. Any shortfall will be absorbed first by the National Lottery's charity fund, which was promised a share of any land receipts over £650m in exchange for bailing out the Olympic budget last year. If the land sells for less still, London's finances will be left with a hole.

Finally, two big bits of planning have yet to be put in place: a detailed vision of how the park will be used after the games, and overall security guidelines. The earlier both are decided, the more carefully developers can design things for their eventual purpose, and the less need be spent on conversions. The Home Office has promised a security plan by the end of the year; the mayor's office says it will have a "masterplan" for the park by early 2009.

Beyond the finish line

Whatever happens now, the Olympic budget will be under pressure. The government already expects that "a significant amount, if not all" of the £2.7 billion contingency will be spent, but insists that the total cost will go no higher than the £9.3 billion agreed last year. With this cap in place and costs rising, compromises look likely.

About time, perhaps. But Londoners must hope that fat is trimmed from the games, not from the permanent improvements that are supposed to improve east London after the athletes have left town. The signs, though, are not good. The National Audit Office has highlighted "a broad pattern…where increased forecast costs for venues are offset by reduced forecasts elsewhere including site preparation and infrastructure". Between November and March, for example, forecast venue costs rose by £78m, whereas those of site preparation, transport and infrastructure fell by £47m. The cost of the aquatics centre rose by 38% in the year to March.

If this trend continues it will be deeply disappointing, given that the only real justification for the games is their legacy. Some overruns seem frivolous in a project that is already more than 170% over its original budget, such as the £6m that was recently added to the cost of the main stadium to meet loading requirements for the grand opening ceremony. The ODA insists that savings on infrastructure have been achieved by competition rather than cuts. But a recent report for the mayor by David Ross, a business mogul, warned of "a real danger that legacy budgets will be seen as the soft option for achieving reductions and savings". As the deadline nears, pressure to make things perfect for the event, rather than for the long term, will increase.

Much of the important work will take place only after the last medals have been given out. The budget includes £350m to convert the Olympic Park and other facilities for everyday use, and the mayor has promised a further £10m a year for the park's upkeep. Mr Ross suspects both sums will be insufficient. The question is whether, when London is no longer in the spotlight, the authorities will bother to do as generous a job on the aftermath as they seem to be doing on the big bash itself.

Crossing the Thames

Flying cars

Aug 7th 2008
From The Economist print edition

Trouble over bridging waters

YOU would not expect Boris Johnson, London's newly elected Conservative mayor, to be popular in Newham, a poor east London borough and Labour stronghold that has become a byword for deprivation and poverty. Yet the shock-haired Mr Johnson will have won at least a few grudging admirers with his opposition to the Thames Gateway Bridge, a £455m ($890m), six-lane road bridge across the Thames that was championed by Ken Livingstone, his predecessor.

East London has traditionally been poorly served by transport infrastructure. The prospect of hosting the Olympic games in 2012 (see article), and a wider plan to build tens of thousands of new homes on semi-derelict land around them, has finally focused minds on the problem. The bridge nearest the site—Tower Bridge—is several hundred metres upstream and unsuited to the new traffic that redevelopment will bring. Yet Mr Livingstone's big new bridge was unpopular with some residents, who complained that it would send more traffic thundering through their borough. Green groups, too, fretted that extra traffic would mean extra greenhouse gases.

In fact, Mr Johnson's opposition to the bridge has been nuanced. "We are certainly not pursuing the current proposal," he told members of the London Assembly, a mayoral watchdog, shortly after taking office in May. Suspicious anti-bridge campaigners worry that Mr Johnson's aides may simply propose a slightly redesigned version.

Others have more iconoclastic ideas. A report commissioned by London's Green Party suggested a cable-car system, familiar to Britons only as a device for ascending ski slopes on their winter holidays. Other cities—including Singapore, Zagreb and Istanbul, as well as a former Olympic host, Barcelona—have adopted them as a form of mass transit.

Boosters point to a string of advantages. Cable cars require little space, are traffic-jam proof and can carry the same numbers of people as a bus or tram (the Greens reckon on 4,000 an hour in each direction, with a crossing time of around two minutes). They are cheap to build and run, encourage walking and, being electrically powered, are greener than the motor car. Best of all, the report burbles, a cable-car system would appeal to tourists and generate "local affection, due to its innovative character, maximum scenic opportunities and 'buzz'."

Impractical utopianism? Perhaps. But the Greens may be on to something. Cable cars would be a natural companion to the London Eye, a gigantic Ferris wheel on the south bank of the Thames that offers panoramic views. Originally intended as a transitory celebration of the new millennium, the Eye today, with 3.5m visitors a year, is Britain's most popular paid-for tourist attraction.

The high price of togetherness

Aug 7th 2008
From The Economist print edition

The bishops got on fine for a while—but was it only a holiday romance?

AP



Shoulder to shoulder—with just about everyone

BY ITS own unusual lights, the Lambeth conference of Anglican bishops was a great success. Its self-imposed task was to avoid any nasty rows between 650 purple-clad gentlemen (and a few purple-clad ladies) who hold widely diverging views on issues which they see as matters of principle, not detail. And a "surprising level of sheer willingness to stay together" was finally reported, on August 3rd, by Rowan Williams, the Archbishop of Canterbury—after nearly three weeks of well-choreographed confraternity in which participants took no votes and made no firm decisions. (Such a luxury would hardly be possible for a body like, say, the International Telecommunication Union, where success is judged by earthly yardsticks.)

Still, the Anglican leader's own standing as a mediator, doing his best to hold together the almost irreconcilable, rose as a result of the gathering. And in a very Anglican way, the thorny issues facing the church were artfully concealed by euphemism and arcane procedures that will unfold over several years. Minds were distracted from trickier subjects by a hyper-inclusive march against poverty.

But the apparent lull in the storms buffeting Anglicanism looks temporary. Among the bishops who attended, there was broad agreement that it would be a good idea to maintain a moratorium in respect of the three actions (two by liberals and one by conservatives) that have nearly split the Communion. These are the consecration of openly gay clergy and, in particular, bishops; the approval of marriage-like rites for same-sex couples; and the "intervention" by conservative bishops (above all from Africa) in the affairs of liberal-dominated dioceses (often in North America). In other words, bishops in the southern hemisphere should stop taking traditionalist parishes or dioceses under their wing and consecrating new bishops for benighted, liberal lands. It was proposed that the woes of conservative communities who feel trapped in liberal dioceses should be addressed by a Communion-wide "pastoral forum" overseen by Mr Williams.

The trouble is that the bishops who are keenest on intervention (from Nigeria, Uganda, Kenya and Rwanda) stayed away from Lambeth because they would not share the communion cup with gay-friendly Americans. It is unlikely that the proceedings will dampen their zeal.

Even among the bishops who did attend, there were moderate conservatives who showed up only in the hope that steps would be taken to rein in the liberals. They got some satisfaction, albeit in the form of a slow-burning fuse known as a "covenant" to which all Anglicans will be asked to subscribe in exchange for full membership of the Communion. The draft covenant contains tough Christian theology and robust words in favour of Christian mission; signatories would vow to avoid hurting Anglican unity. There is an appendix that provides, amid a web of elaborate procedures, for dissenting churches to be expelled.

Archbishop Williams said it might take a year to perfect the covenant, and another four before all the Communion's 38 provinces consider it. It is hard to see liberal Americans or Canadians signing up; and despite the happy mood at Lambeth, nobody would bet much money on the American Episcopalians refraining from approving same-sex unions at their General Convention next year.

On the brighter side (from the Communion's viewpoint), some Americans who went to Lambeth do now have a better sense of the social and political constraints on bishops in traditional societies. (One African bishop recalls that after news reached his country of the gay-friendly stance of America's bishops, a senior Muslim asked him, in bewilderment, whether he too had ceased to be Christian.) "I came to understand as never before that there are places and cultures where it is not possible to discuss [homosexuality]," said Bishop Jeff Lee of Chicago.

As the conference proved, human chemistry can change when people committed to the ideal of loving one's foes hold long private meetings in small groups. It is hard for them to go on saying, afterwards, that their interlocutors are not only mistaken but bad and dishonest. But *indaba*—the Zulu practice of open consultation, which the conference borrowed—can't go on for ever; ultimately bishops return to their respective local realities.

Gene Robinson, the gay American bishop whose consecration in 2003 triggered the current crisis, was kept out of the Lambeth conference; his presence would have led to a larger boycott. Had he been inside, he might have refrained from his recent, rather startling statement that he was "not interested in becoming a martyr". That would have been a tactless thing to say to the face of any African prelate from a war zone, who faces daily calculations about the price of his life.

Catholics and Anglicans

Anyone for Schadenfreude?

Aug 7th 2008 | ROME
From The Economist print edition

What Roman Catholics fear from an Anglican split

Get article background

THE Archbishop of Canterbury was not the only church leader to be thankful that the Lambeth conference ended with the Anglican Communion still in one piece. An almost audible sigh of relief could be heard from the Vatican.

"The last thing the pope would wish to do is support any kind of division," said Keith Pecklers, a Jesuit professor of Liturgy at the Gregorian University in Rome. That may seem odd. If the Church of England splits, Catholicism stands to gain new adherents. Traditionally minded Anglican priests and bishops—and, in some cases, most of their flocks—can be expected to defect to Rome.

One reason why senior Catholic clerics view a possible schism with dismay is personal and emotional. As the Second Vatican Council's decree on ecumenicism noted, the Anglican Communion occupies a "special place" in relation to the Catholic church. In the 44 years since then, many Catholics have invested time, effort and prayer in trying to reunite with the Church of England, and there have been moments when they dared to hope it was possible. Good friendships and working relationships have been formed along the way (one is between Rowan Williams and the Archbishop of Westminster, Cormac Murphy-O'Connor). No one likes to hear a row in a friend's house.

But there are other, less sentimental reasons why the Catholic hierarchy dreads a split. In particular, the acceptance into the Catholic church of large numbers of married Anglican clerics would make it harder for the Vatican to hold its already shaky line on priestly celibacy. Since 1980, when rules were drawn up for the reception of Anglican clerics (some of whom were unhappy at the prospect of women priests in their Communion), more than 80 have taken the leap worldwide. Most are married. Catherine Pepinster, the editor of a liberal Catholic weekly, the *Tablet*, says that in Britain most Catholics feel that these priests "bring something beneficial to their ministry. They understand people's married lives, and that is appreciated."

The refugees from any future schism could prove far more numerous than the trickle who have eloped to Rome to date, however. So those Roman Catholics who would welcome a more tolerant attitude towards homosexuality, or the greater involvement of women, could see their cause set back by the arrival of the rebels. "High" Anglicans can be more papist than the pope. As Ms Pepinster notes, their services can contain "more smells and bells than you would find in the average Catholic parish".

Economist.com



Northern Rock

Of banks and men

Aug 7th 2008
From The Economist print edition

The mortgage lender's cash call is an ominous sign for all British banks

STUDENTS of politics (and more than a few politicians) know only too well the old dictum about lies that are repeated often enough becoming truth. Those foolish enough to believe it should take a look at the sorry tale of Northern Rock, a troubled mortgage lender that failed last September when it ran out of cash. For almost a year afterwards Alistair Darling, the chancellor of the exchequer, repeated, mantra-like, that this was a sound bank brought low by events from afar, and that taxpayers would get back every one of the billions of pounds they lent it. On August 5th Mr Darling was mugged by reality when Northern Rock came to him, cap in hand, again.

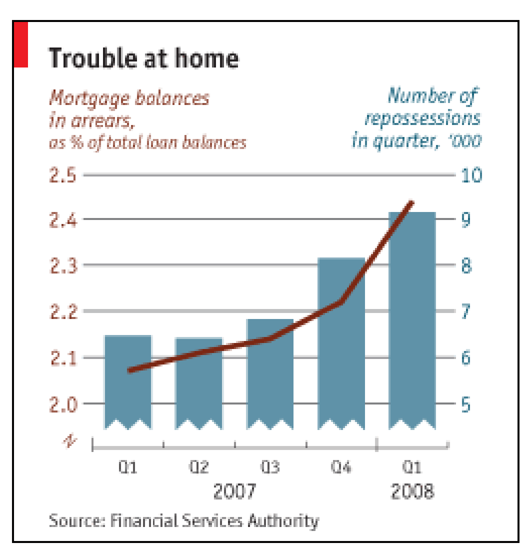
This time the bank wanted help in shoring up its balance-sheet, which is crumbling thanks to a mortgage book that looks worse by the day. The government, which is still owed some £21 billion ($41 billion) by the hapless bank, has agreed to convert as much as £3 billion of the debt (as well as some £400m in preference shares) into ordinary shares. This urgent need for capital should make those who still think taxpayers will get all their money back think twice. So should those who dare to hope that Britain's banks have seen the worst of the credit crisis.

Northern Rock needed more government help because the cushion of capital it holds against bad loans deflated alarmingly in the first half of the year, leaving it dangerously undercapitalised. In the first six months it posted a net loss of £565.5m; without the extra money, similar losses in the second half would have brought it within a hair's breadth of running out of regulatory capital. This injection has bought it time. But there is little hope that it can stem its losses, most of which arise from bad loans in its mortgage book. And the bank has mainly itself to blame for it.

For much of this decade it expanded rapidly. All the way up to, and then beyond, the peak of the housing market last summer it helped customers pile on debt, lending buyers who could not scrape together a deposit up to 125% of the value of a property. Such loans account for about a quarter of Northern Rock's mortgage book and they are going bad fast. Arrears on them have trebled in the past year (from 0.7% to 2.1%) and are now almost double the industry average for all mortgages.

Some of the increase in arrears is an illusion caused by a shrinking mortgage book. In order to repay the government its loan (and to avoid falling foul of European rules prohibiting companies that get state aid from competing unfairly), the bank is encouraging existing customers to take their business elsewhere. Its very best ones are doing just that. But those who have already missed payments or who flunk credit tests at other banks are being left behind at Northern Rock.

The bank's dwindling balance-sheet may make it look worse than its rivals, but Northern Rock was not the only reckless lender in a market convinced that house prices could only keep rising. All banks are now afflicted by a slowing economy and falling house prices, which are driving up arrears and repossessions (see chart). On August 7th Barclays joined the queue of banks bearing bad news, with pre-tax profits down 33% and predictions of tough times ahead. One sign of desperation is that the government may scrap transaction taxes on home sales in a bid to breathe life into the market.



A steep rise in bad debts could not come at a worse time for British banks. They are only now getting their heads back above water after raising capital from investors to rebuild balance-sheets battered by write-offs on exotic bonds and derivatives backed by iffy American mortgages. There is a real risk that they will be faced with a fresh wave of write-downs, this time home-grown, and be

forced to ask shareholders again for cash—lots of it.

A few months ago only the most pessimistic analysts were musing about the impact on banks of a 1990s-style recession. Then, predictions that banks' loan losses might approach £20 billion were seen as fanciful. Now gloom is a growth industry, and such dire estimates are commonplace. Some reckon that losses may be far higher: consumers are more heavily indebted going into this recession than they were before the last one, and inflation is lower, which means that nominal house prices may fall further. More cash calls from banks seem certain. Whether shareholders will be willing to dig deep a second time is far less clear.

Energy dilemma

Cheap or green?

Aug 7th 2008
From The Economist print edition

When poverty and greenery collide

Reuters



THE Camp for Climate Action—an annual gathering of anarchists and environmentalists—is fast becoming a summer fixture. Having protested outside Drax (a big coal-fired power plant) in 2006 and Heathrow airport in 2007, this year they are pitching tents in Kingsnorth, an industrial bit of Kent that is the proposed site of what would be the first new coal power station to be built in Britain for two decades.

The protesters point out that coal is the dirtiest fossil fuel and argue that, given official pledges to cut carbon emissions, building new plants using it would be “stupid”. Their ambition is to shut down the existing Kingsnorth station, which is also coal-fired, for a day. There have already been several arrests and clashes with the police (whom protesters accuse of harassment); more seem likely on August 9th, their officially designated “day of mass action”.

The government’s energy policies are being attacked from all sides, by anti-poverty campaigners and businesses as well as by greens. That is because it is caught on the horns of a nasty dilemma. A plethora of coal and nuclear power stations are due to close over the coming decade and will need to be replaced. At the same time, Britain has vowed to produce significant cuts in its greenhouse-gas emissions.

The cheapest way to prevent an electricity crunch is to allow new fossil-fuel stations to be built. This is already happening: Kingsnorth, if constructed, would be only one of six new coal plants planned, and there are gas-fired plants in the pipeline too. But encouraging new fossil stations risks busting the government’s array of green targets, which commit it to reducing carbon emissions by a fifth—compared with 1990—by 2010 and by three-fifths by 2050. (A separate European target, to produce 15% of all energy, including heating and transport as well as electricity, from renewable sources by 2020 can be politely described as “ambitious”.) For a government that has called climate change “the biggest threat facing mankind”, that would be intensely embarrassing.

The alternative, though, is no more attractive, for expensive energy is the likely price of meeting green goals. Land-based wind turbines are reasonably cheap but function best in the sort of windswept beauty spots that locals like to keep unblemished, so many have stalled in the planning process. Ministers have instead placed their faith in offshore wind farms, but waterproofing windmills makes them more expensive. Even coming close to the European targets, say government advisers, would mean a sevenfold rise in onshore wind capacity and a 46-fold rise in offshore. Subsidies for renewables (£634m in 2006-07) currently add only slightly to bills, but a big expansion of renewable energy would mean higher prices.

The future of the other great green hope—nuclear power—is equally uncertain. The government insists that a European carbon-pricing scheme will allow the private sector to build reactors without explicit state subsidies. It had hoped that a takeover of British Energy, a nuclear firm, by EDF, a French giant, would kickstart private-sector interest. But EDF was abandoned at the altar on August 1st, after two big British Energy shareholders decided that, in light of the likely future price of power, its offer was too low.

A deal may still be possible, but even if investors can be found, nobody knows just how much private nuclear electricity will cost. News from Finland (which is building a reactor similar to those planned for Britain) is not good, with the project reportedly €1.5 billion (£1.2 billion) over budget.

Pricey power, fuelled by high oil prices, is already causing headaches, with MPs muttering about windfall taxes on utility firms and talismanic pledges to reduce fuel poverty (defined as living in a household that spends more than 10% of its income on heating) in tatters. Neither dirty electricity nor expensive electricity holds much appeal. Energy efficiency and better home insulation is one way out of the government's dilemma, but insulating Britain's notoriously draughty housing stock would take years. In the meantime, Malcolm Wicks, the energy minister, said on August 3rd that "we are not going to sacrifice fuel poverty on the altar of climate change". Climate campers should prepare for disappointment.

Pensions accounting

Choose a number

Aug 7th 2008
From The Economist print edition

Silly accounting may be obscuring a black hole in pension funds

UNITED UTILITIES and Scottish and Southern Energy are similar in many respects. Both are energy utilities that supply electricity and gas. Both employ thousands and run huge pension funds. Yet when calculating the cost of those pensions, the similarities end. The two companies have chosen to use very different assumptions—and these choices have a big impact on the pension surplus or deficit on their balance-sheets.

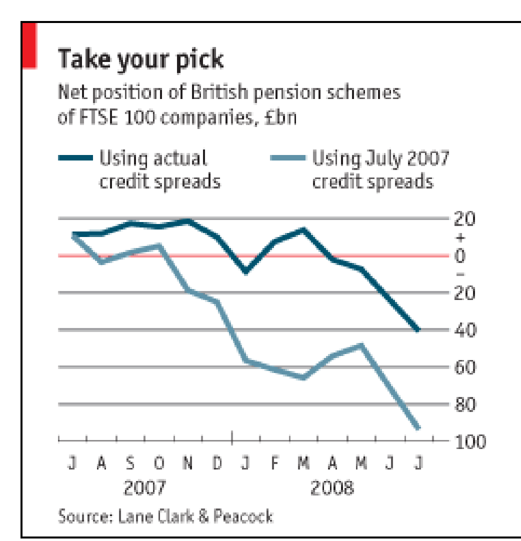
When discounting their eventual obligations (figuring out the cost today of paying pensions years in the future), United Utilities has used a rate of 6%, Scottish and Southern one of 6.9%. The difference may not seem much, but Lane Clark & Peacock, a firm of actuaries, reckons that Scottish and Southern's pension liabilities come out about £350m lower than if it had used United's rate—a material difference for a fund that in 2007 was £92m in the red.

This example demonstrates the difficulty that investors and employees have in assessing the health of pension funds at individual firms. It also points to some glaring gaps in accounting rules that may be hiding a black hole in many pension funds that is bigger than most imagine.

This was never meant to be. Accountants this decade introduced new rules aimed at making pension deficits more comparable across companies. They are already showing themselves inadequate.

The biggest problem is that the discount rate firms are required to use is the interest rate that bondholders demand for holding the debt of creditworthy companies. Yet turmoil in credit markets has made this a flaky measure. First, investors are now demanding very different rates for buying the bonds of different, though equally creditworthy, companies. There is no agreement on a uniform "corporate spread" to serve as a benchmark. So pension funds each pick a rate from a range.

The credit crunch has also increased the gap in general between interest rates on corporate bonds and those on government bonds. Investors, not unreasonably, think companies are a lot more likely than countries to go bust. But that, perversely, has reduced apparent pension deficits by raising the rate at which future liabilities are discounted. Had bond spreads not widened, the total pension deficit of FTSE 100 companies would be about twice its current £41 billion, Lane Clark & Peacock reckons (see chart).



And even that number may be an understatement. Robert Gardner of Redington Partners, which advises firms and pension funds, estimates that the FTSE 100 pension deficit could be twice as big again, at £160 billion.

Some experts, however, including David Blake of the Pensions Institute at Cass Business School, question the wisdom of reducing pension funding to a single number on the balance-sheet, given that it is based on forecasts about inflation, longevity and wages far into the future. He would rather companies reported confidence intervals around the best estimate of pension liabilities to reflect the uncertainty inherent in the calculations. This might be more accurate, but the poor worker nearing retirement would be out the door before he had the faintest clue what it all meant.



Geopolitics (1)

A bowl of thin alphabet soup

Aug 7th 2008
From The Economist print edition

The Kremlin wants a new security club for Europe and Asia. Can it work? And should it worry America, which (see article) is relearning to love its allies?

Illustration by Claudio Munoz



WHETHER the story is Muslim separatists killing Chinese policemen, Iran threatening to close the Strait of Hormuz to Western oil tankers, lethal fighting in a breakaway province of Georgia or Russia planning to put nuclear bombers in Cuba in retaliation for perceived American adventurism in Europe—just to take news items from the past few days—it is easy to see why officials in Moscow, Beijing and elsewhere think the security of the Eurasian land mass could be in better hands. Old alliances such as NATO, and looser outfits such as the Organisation for Security and Co-operation in Europe (OSCE), do not seem to fit the bill. They are, critics say, too narrow in their membership, legally flimsy and too old-fashioned in their scope. High time, so it would seem, for something better.

That, roughly, is the thinking in Moscow, where for the first time in years Russia seems to be offering new ideas rather than old grumbles. Fuller details are promised in September. For now, the plan as outlined by President Dmitry Medvedev, and promoted by Russia's ambassador to NATO, Dmitry Rogozin, is to have a big international conference in Moscow next year, attended by all NATO and EU countries, Russia and its ex-Soviet allies, as well as China and (probably) India, to set up a new security organisation to deal with issues such as terrorism and illegal migration. And who could object to that?

So far, the Western response has been muted. Some countries in Europe like the idea of a security structure that would rely less on American hegemony and more on international law. Others are privately sceptical, but think it would be rude to dismiss the plan before hearing it in full.

The idea of security organisations that span Europe and Asia is nothing new. Russia and China set one up by treaty in 1996. In 2001 it became the six-member Shanghai Co-operation Organisation (India and three other countries are observers). This aims to deal with the three big dangers (at least as seen by autocratic multi-ethnic countries): terrorism, separatism and extremism. The outsiders who support Islamist extremists in the North Caucasus are likely to be the same people who back Muslim separatists in China's far west and insurgents in Uzbekistan's Fergana Valley—so the thinking goes. The SCO's chief role is still to swap information and co-ordinate anti-terrorist work.

It has gained weight since then, becoming both a talking-shop for countries twitchy about American dominance and developing a loose military role. Last year member states played war games in Central Asia—the biggest Russian-Chinese shindig of that kind since the Sino-Soviet split half a century ago. That

prompted panicky reactions: “OPEC with bombs” or “the WWW” (World Without the West).

Such talk is exaggerated. Bobo Lo, a London-based security pundit and author of a forthcoming book called “Axis of Convenience”, says the SCO’s main aim is to promote Russian and Chinese interests in Central Asia “without spooking the natives”—in other words, smaller countries in the area. If it becomes too controversial, it loses usefulness. A Tajik-backed bid for Iran to get full membership, launched in April, has got nowhere.

One aim of the Russian plan may be to nudge Western countries into taking the SCO more seriously. It would have a seat at the table at the planned conference, ranking alongside international bodies such as NATO. Western nervousness about the SCO and similar bodies risks looking hypocritical: the EU and NATO fume about Russia’s use of “divide and rule” tactics, using bilateral arrangements to undermine multilateral organisations. Yet that is pretty much how the West treats Kremlin-sponsored international organisations.

But the big problem facing any new organisation is not Western fastidiousness but deeper conflicts of values and interests. Even the SCO does not function altogether smoothly. Russia and China are partners on some things, but rivals on others. Arms sales from Russia to China have slumped in the past two years. Russian policymakers realise that a rising China will become a steadily stronger neighbour, keen to redress past injustices. In the long term, says Mr Lo, these may include “red line” issues, such as the territories that a weakened Chinese empire ceded to tsarist Russia. That imbalance seems to be diminishing Russian enthusiasm. Russia is resisting full Chinese membership of the G8. Talk in Moscow of a “multipolar world” has given way to praise for “common European civilisation”. “They are worried that in a multipolar world not all poles are going to be equal,” says Mr Lo.

So how would the new Eurasian security organisation reach agreement? Disputes between pro-Western and pro-Russian states have crippled the consensus-based OSCE, an outfit that was once much liked by Russia as a non-military alternative to NATO. Russia banned OSCE election monitors from recent elections and has sidelined it in escalating conflicts such as Georgia (see article). So the new outfit is unlikely to find agreement more easy.

America and European countries will be encouraged if Russia truly wants to be part of a space that foreign-policy wonks such as Dmitri Trenin at the Carnegie think-tank in Moscow call the “Greater West”. But the problem is that being “Western” is hard to define. Speeches by Russian policymakers seem to reflect a 19th century understanding of Western-ness, based on a mixture of national sovereignty and a common cultural heritage in Christianity.

Those ideas are out of step with the realities of the 21st century. Western countries now sign up to lots of sovereignty-limiting multilateral accords, and try to live up to agreed standards on human rights and political freedom. Such agreements are anathema to many in Russia and other SCO countries, who see them as hypocritical and irrelevant to security.

In practice, it is often either the propagation of common values (in the case of NATO) or common dislike of those values (in the case of the SCO) that provides the sort of glue that can hold an international body together. Is any ideological glue strong enough to fuse the whole of Eurasia into a single unit? On any of the challenges common to all the countries in that vast area—from collective security to energy supplies to minority rights—views diverge. Until that changes, the prospects for the Russian grand design look dim.

Geopolitics (2)

Win today's wars first

Aug 7th 2008
From The Economist print edition

A chastened Pentagon emphasises soft power and partnerships over military force

AP



Even big guys need friends

CHINA is rising, while Russia is becoming worryingly assertive. But for the foreseeable future, America's Department of Defence says, America's biggest worry will be small messy wars, fought with messy alliances with messy outcomes; more Iraqs, Afghanistans and campaigns against the likes of al-Qaeda.

The Pentagon now calls this the "Long War against violent extremist movements" (dropping the old appellation of the "Global War on Terrorism"). Military force is no longer the only, or even the primary tool. Soft power rather than hard power is given priority: less emphasis on the need to capture and kill terrorists, and more on winning the allegiance of indigenous populations for their local governments. The most important military task, says the new National Defence Strategy, released by the Pentagon on August 1st, "is not the fighting we do ourselves, but how well we help prepare our partners to defend and govern themselves."

This sums up much of what Robert Gates, the defence secretary, has been saying of late. Yet the strategy is unusual in that it was issued in the dying months of the administration of George Bush. A new president will no doubt order a rethink. Plainly Mr Gates wants to pass on the lessons America has learnt the hard way, and bequeath a military machine pointing firmly (though reluctantly) in the direction of counter-insurgency and not just big conventional wars. Indeed, some wonder whether Mr Gates himself might not stay on under a new president. Moreover, he has told subordinates not to leave if asked to facilitate America's first "wartime" transition since the Vietnam war.

Mr Gates's strategy is a world away from the last one, produced under Donald Rumsfeld in 2005. Gone is the hubristic talk of defeating "adversaries at the time, place and in the manner of our choosing", as is the warning that state sovereignty is no protection for rogue states and the unilateral idea of working with allies only "when we can".

Mr Gates's view is more humble, seeing a complex world where American power is curtailed, and military action must give way to diplomacy, as well as economic and other civilian levers. The system of international rules is less a constraint on America, more a vital element of its security; allies are assets who "often possess capabilities, skills and knowledge we cannot duplicate".

Dealing with ungoverned space where terrorists may thrive is not just a matter of being able to insert military forces, but of "working with and through local actors whenever possible" to help them extend their writ. The paper's view of "victory" is nuanced; it will involve "discrediting extremist ideology, creating fissures between and among extremist groups and reducing them to the level of nuisance groups."

All this is not to say that America ignores other geostrategic problems. The Pentagon says it must retain the ability to defeat "rogue states" such as Iran and North Korea. America must also "hedge" against big powers, particularly China's growing economic and military power.

The strategy expresses strong concern about Russia's "retreat from openness and democracy" and more assertive stance—not least its claims to parts of the Arctic, the bullying of neighbours and the resumption of long-distance bomber flights. "We do not expect Russia to revert to outright global military

confrontation, but the risk of miscalculation or conflict arising out of economic coercion has increased," it says.

America retains the world's pre-eminent military force, spending almost as much on defence as all other countries together. But precisely because of this military prowess, enemies will seek "asymmetric" means to counter it. That means America must "display a mastery of irregular warfare" rather than wish it away.

The document says little about the structure of America's armed forces, or its spending priorities. But it points to supporting the army at the expense of the navy and the air force, which argue that the threat of China requires more spending on advanced aircraft, ships and space assets. Mr Gates regards such thinking as a dangerous disease—"next war-itis", he calls it. His strategy is to dedicate "substantial but not infinite" resources to keep an advantage over China. But the priority is to try to win today's wars.

Dealing with the downturn

Make love—and war

Aug 7th 2008 | SAN FRANCISCO
From The Economist print edition

Tough times are producing some surprising business bedfellows

Illustration by Peter Schrank



COMPETITORS often find it hard to be civil to one another in public. But few rivalries have been as nasty as that between two New York newspapers, the *New York Post* and the *Daily News*. The “Daily Snooze”, as the *Post* dubs its rival, takes great pleasure in rubbishing its arch-enemy, and vice versa. Scurrilous gossip about the *Post*’s owner, Rupert Murdoch, is avidly reported by the *Daily News*; its proprietor, Mortimer Zuckerman, has been the target of less than flattering coverage in the *Post*. And the two titles like to bicker over which has the bigger circulation.

Yet behind the scenes executives from both papers are talking about working together in some areas, such as distribution, in an effort to slash costs. Nor are they the only rivals thinking the previously unthinkable. With the global economy on the rocks, businesses everywhere are desperately searching for ways to save money or boost revenue—even if they require collaboration with the enemy.

Arrangements in which firms compete vigorously with one another, while also co-operating in specific areas—known in management jargon as “co-opetition”—are not new. Carmakers have long collaborated on vehicle platforms, engines and so on to achieve economies of scale. And airlines have shared check-in, gate management and other facilities.

But given the dire state of both those industries there are likely to be more such deals. In July BMW, which makes the Mini, and Fiat, which produces the rival MiTo under its Alfa Romeo brand, said they were considering joint production of components and systems for their vehicles. “There has definitely been an uptick in co-opetition,” says Barry Nalebuff, a professor at Yale School of Management and the co-author of a book on the subject.

Let’s be frenemies

Economic pressures have also brought New York’s feuding dailies to the negotiating table. Even in good times, the *Post* lost millions of dollars a year and the *Daily News* struggled to turn a modest profit. Now, with advertising migrating to the internet and the economy slowing, things look even bleaker. (On August 5th News Corporation, the *Post*’s parent, reported healthy profits for the last quarter of its fiscal year, but warned that next year’s growth would be “less robust”.)

While newspapers are already carrying fewer ads, parcel-delivery companies fret they may soon be carrying fewer packages. Faced with an ailing American economy, two such firms, DHL and UPS, are planning to collaborate in the express-delivery market there. Under the terms of a proposed ten-year deal, UPS, which has some excess capacity in its American air-freight network, would carry DHL's packages on its planes inside America—and between the United States, Canada and Mexico—for a fee of up to $1 billion a year.

The impetus for the deal came from DHL. Its American express-delivery business is bleeding red ink. By working with UPS and restructuring its own ground-delivery network, the German-owned firm plans to slice its losses in America from a forecast $1.3 billion this year to $300m by 2011. As for UPS, it could do with the cash: its second-quarter operating profit shrank by 18%, to $1.45 billion, owing to rising fuel costs and the stagnant American economy.

Crafting co-opetition deals is a tricky business, not least because potential partners need to swallow their pride first. Firms also need to be very clear about what will and will not be covered by a deal. “You have to figure out exactly where you are co-operating and where you are competing, and not get your staff confused,” says Harold Sirkin of the Boston Consulting Group.

Newspapers, for instance, tend to differentiate themselves by their editorial content and the quality of their advertising-sales operations. So editorial and advertising departments of rival papers must be kept separate if they are to retain their distinctive identities. But distribution, printing and back-office operations are easier to consolidate without blurring brands—which is why the *Post* and the *Daily News* are exploring such possibilities.

Clarity is also essential when it comes to persuading antitrust watchdogs that a link-up is benign. Sometimes even the whiff of co-opetition can cause other firms to cry foul—as Microsoft did a few months ago when it emerged that Yahoo!, an internet firm, was planning to outsource a chunk of its search-advertising business to Google, its main rival. Would-be partners must be able to show that it is in customers' best interests for them to co-operate.

UPS and DHL stress that their proposed deal just covers air freight; they will still compete in all the other bits of the express-parcel business, including ground collection and delivery. (They also point out that FedEx, another competitor, carries express packages by air for the US Postal Service.) “When this deal is finalised, nothing will change the fact that we are a rabid competitor of DHL,” says a UPS executive. DHL says it will bite back by using the savings from the UPS deal and from reconfiguring its ground network to offer a cheaper alternative to services from UPS and FedEx.

Frank Appel, the boss of Deutsche Post World Net, DHL's parent, is confident that a deal with UPS can be reached before 2009. But it could be blocked by a legal challenge from unions which are furious that the firm is closing its air hub in Wilmington, Ohio, triggering thousands of lay-offs. Mr Appel says he needs to stanch DHL's huge losses in its American express service now to prevent many more job losses in future.

As for the *Post* and the *Daily News*, it seems unlikely that any deal would encompass areas, such as advertising, that would worry trustbusters. And merging the editorial teams would be unthinkable—which means readers will still be able to enjoy the tabloids taking potshots at one another in print.



BUSINESS

MBAs and the economy

Ports in a storm

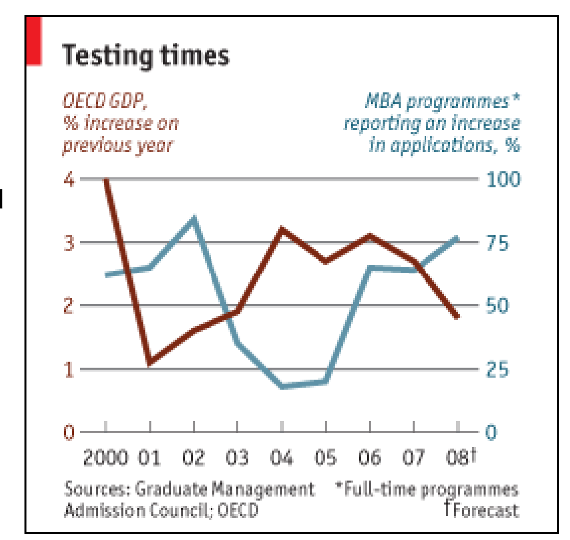
Aug 7th 2008 | SAN FRANCISCO
From The Economist print edition

Business-school applications pick up as the economy slows

Get article background

ANYONE wanting further proof that the world economy is in trouble need look no further than the nearest business school. Many schools are hailing a bumper year for their full-time Master of Business Administration (MBA) programmes, which are popular with executives looking to hone their moneymaking skills while sitting out a downturn. Worryingly for those betting on a swift economic recovery, business schools reckon that next year could yield an even bigger crop of applicants.

During the previous downswing the percentage of full-time MBA programmes reporting higher applications soared as tech stars switched to textbooks (see chart). The pace slowed as the economy improved, but then picked up again. Preliminary figures from the Graduate Management Admission Council (GMAC), an international organisation of business schools, show that 77% of full-time programmes have reported higher demand for places this year.



Admittedly, the state of the economy is not the only factor driving demand for MBAs. Students from India, China and eastern Europe have swelled the ranks of applicants. But the business cycle still has an important influence. The biggest cost of undertaking an MBA is often the earnings forgone while studying. In difficult times those earnings may fall or even disappear, reducing the opportunity cost of taking a year out.

This helps to explain why demand for places is up this year, even as falling house prices make people feel poorer and the credit crunch makes student loans pricier. “Several months ago we were nervous about the impact of the financial crisis, but it does not seem to have been a major impediment,” says Mark Mallinger, associate dean of full-time programmes at Graziadio School of Business at Pepperdine University in California, which has seen a 30% rise in applications. Others reporting double-digit increases include the London Business School and the Stern School of Business at New York University.

“We’re predicting a very strong applications market through 2010,” says David Wilson, the chief executive of GMAC. Registrations for its Graduate Management Admission Test are forecast to exceed 249,000 this year, an all-time high. Scores on the test, which 1,800 business schools require, are valid for five years. Of course, there is no guarantee that students who embark on MBAs now will be able to walk into their ideal jobs when they emerge clutching their new degrees. But they may stand a better chance of doing so than this year’s graduates, who must grapple at first hand with the practical implications of the macroeconomic theory they learnt in class.

Alitalia

Miracle postponed

Aug 7th 2008 | MILAN AND ROME
From The Economist print edition

Silvio Berlusconi is struggling to put together an Italian solution for Alitalia

Reuters



"WE WILL perform another miracle and will offer Italy a profitable national airline." That was the promise from Silvio Berlusconi, Italy's prime minister, this week as his government postponed the announcement of a long-awaited plan to rescue Alitalia, the country's lossmaking flag-carrier. The "miracle" was to have been discussed at a board meeting on August 8th and revealed soon afterwards, but will now be a secret until September. The stated reason is to avoid disrupting the summer holidays with strikes and cancelled flights. But many people reckon the plan is being delayed because it is controversial and, in some ways, incomplete.

Alitalia is in such dire straits that only a recent loan of €300m ($480m) from the government is keeping it flying. Air France-KLM made an offer for Alitalia in March, but withdrew its bid after failing to reach agreement with Alitalia's unions—and after Mr Berlusconi said during his election campaign that selling Italy's flag-carrier to a French rival would be unacceptable.

Intesa Sanpaolo, the bank subsequently given the job of finding new Italian investors for Alitalia, quickly found that there was no chance of getting anyone to put money into the airline in its current form. "That was a dream," says a person familiar with the bank's thinking. Instead, it has devised a plan to split Alitalia in two.

One part would be a new, privately held company, with no debt and fresh equity of €1 billion contributed by a dozen or so Italian industrialists, including Gilberto Benetton, Luigi Aponte and the Marcegaglia family. The new firm would take over Alitalia's best assets and some from Air One, a smaller Italian airline

with a newer fleet. If all went as planned, the new airline would become profitable from 2009 and would float on the stockmarket in 2010.

The new investors, of course, want nothing to do with Alitalia's disastrous past. So the government would own the "old" company (it owns 49.9% of Alitalia), which would retain the airline's €1.1 billion of debt and its unwanted assets. Three-quarters of Alitalia's 20,000 workers would move to the new company and the rest would stay with the old. "The new, appetising company would be sold and the bad company would simply be a liability for public-sector finances," concludes Enrico Letta, an opposition politician.

It is unclear whether Giulio Tremonti, the finance minister, would accept such a division. Having just won parliamentary approval to cut spending by €30 billion, he is likely to resist having Alitalia's liabilities dumped on the public finances. And the European Commission, which is already investigating the loan to Alitalia as a case of illegal state aid, is likely to object. Greece tried a similar split with its lossmaking flag-carrier in 2003, notes Rigas Doganis, an aviation-industry commentator. Brussels found that the split was a way to provide cover for continued state aid.

Observers also question how committed the Italian investors are. A condition of Intesa Sanpaolo's plan is that a big foreign airline be brought in as a partner for the new Alitalia, and Mr Benetton recently said that such an alliance was vital for the project's success. Lufthansa, Europe's second-biggest airline, is the likeliest candidate, but has not confirmed any interest.

If the government can corral new investors for Alitalia, it will then have to decide how to split the firm. The law says Alitalia would have to go through a procedure similar to bankruptcy in order to split itself in two and have its debt stay with one half, says Edoardo Staunovo Polacco, a lawyer who specialises in bankruptcy. The government wants to revise the law to speed things up, but has so far denied that Alitalia will be placed in bankruptcy.

After being elected, Mr Berlusconi warmed towards Air France-KLM, but it was too late. Many in his party must now bitterly regret the missed opportunity—the French airline would, after all, have bought Alitalia, debts and all. They must be hoping that Air France-KLM will return to the table or that Lufthansa will make a bid. That really would be a miracle.

Phones on planes, continued

The dial-high club

Aug 7th 2008
From The Economist print edition

Mobile phones on planes may not be as annoying as some people think

Illustration by Peter Schrank



AS AIRLINES struggle with high fuel prices, they have been looking for new ways to generate "ancillary revenues". This week JetBlue, an American airline, said it would start charging $7 for a pillow and blanket on some flights. Other airlines are demanding extra to check in luggage, or for more legroom. And as the regulatory hurdles to using mobile phones on planes continue to fall, airlines are salivating at the idea of charging passengers $2.50 a minute to make calls and 50 cents for a text message.

It should come as no surprise that Ryanair, the leading European low-cost carrier, which generated €488m ($690m) in ancillary revenue last year, is one of the most enthusiastic proponents of in-flight calling. It plans to fit its entire fleet with the necessary equipment, which is being provided by OnAir, an in-flight communications provider backed by Airbus, Europe's planemaking giant. Oman Air, TAP Portugal, bmi and AirAsia are also adopting OnAir's technology. AeroMobile, a rival technology provider, has signed up airlines including Emirates, Qantas and Turkish Airlines.

The technology works (handsets talk to a tiny base-station, or "picocell" on the plane, which connects to the phone network via satellite); safety concerns and worries about interference with ground-based networks have been overcome (though phones will have to be switched off for take-off and landing); and airlines are convinced of the business case. But what do passengers think? Many have expressed concern at having to sit next to tedious blabbermouths.

So the results from the first trials of in-flight communications equipment are reassuring. Emirates has installed AeroMobile's equipment on ten of its aircraft since March. On July 30th AeroMobile said reaction had been "overwhelmingly positive", with around half of passengers switching on their phones during flights. Text messaging proved most popular, and the average length of voice calls was just 2½ minutes. Most of these calls were made on daytime flights; the number on night flights was "minimal".

Air France, which has been testing OnAir's gear on short-haul flights in Europe and north Africa, says 80% of those polled wanted the service to be deployed across the airline's entire fleet. On a typical flight about 100 text messages were sent or received and ten megabytes of data transferred by a dozen BlackBerry users. Passengers said they liked being able to inform people on the ground of changes in their arrival details.

In short, fears that in-flight telephony will be a nuisance, rather than a benefit, seem to be wide of the mark. That is good news for passengers hoping to get some sleep—and for airlines desperately looking for new sources of revenue.

 BUSINESS

The American car market

Detroit's race against time

Aug 7th 2008
From The Economist print edition

Will the Big Three's cash last long enough for them to fix themselves?

WITH each successive month the plight of Detroit's Big Three manufacturers—General Motors (GM), Ford and Chrysler—becomes a little more desperate and their eventual fate less certain. July's figures for light-vehicle sales in America, released last week, were unremittingly awful. Seasonally adjusted and annualised, sales fell to 12.5m from 15.3m last year. As in previous months, sales of pickups and sport-utility vehicles (SUVs), down by 31% year on year, were worst hit. But even car sales, hampered by supply shortages of the fuel-sipping compact models Americans now suddenly want, fell by 7.4%.

Reduced access to credit also had an impact, as carmakers become increasingly reluctant to finance lease agreements. Typically, at the end of a three-year lease, a vehicle is returned to the manufacturer which then disposes of it, usually profitably, at auction. But the prices being paid for used trucks are down by about 20% compared with last year. Chrysler Financial is losing $5,000 on every truck it takes back. At the end of July Chrysler stunned its dealers by saying it was getting out of leasing entirely. Ford and GM have not yet gone as far, but they are scaling back leasing in an effort to reduce future liabilities.

The amount of new-car business that leasing accounts for varies from dealer to dealer. But for some dealers, more than half of turnover comes from leasing. Everyone has been affected, but the Big Three, with their model line-ups skewed towards the pickups and SUVs that are now out of favour, have been hurt most. GM's sales in July were down by 32%, Chrysler's by 34% and Ford's by 20%. Their combined market share in America sank last month to an all-time low of 43%.

July's wretched sales figures came hard on the heels of shocking losses announced first by Ford and then, a few days later, by GM. Ford's $8.7 billion loss was its worst ever, and GM lost an eye-watering $15.5 billion in the quarter, the third-biggest loss in its 100-year history. Both firms took charges for huge restructuring costs, reflecting the acceleration of plans to take redundant capacity out of production and convert truck plants to making cars. There were also hefty write-downs on toxic leases.

Chrysler, which is privately held, does not release financial data, but was forced by growing rumours of impending bankruptcy to issue a statement saying that despite the market turmoil, it was running ahead of its operational plan and had plenty of cash to see it through—a claim met with some scepticism. But if the speed with which the Detroit firms are burning cash is the biggest immediate cause for concern, the deeper question is whether they are using what remains to make their businesses viable in the long term.

Reuters



I want you to buy GM's cars

GM ended the quarter with $21 billion in cash, which sounds like a lot—but the firm is eating $1 billion a month. A few weeks ago, Patrick Archambault of Goldman Sachs, an investment bank, estimated that by the end of next year GM would only have about $8.7 billion left unless assets were sold or debt raised. In a bid to ease such fears, GM's embattled chief executive, Rick Wagoner (pictured), announced the latest in a series of turnaround plans on July 15th. It included $2.5 billion-worth of cuts in marketing and capital expenditure, and a commitment to raise up to $7 billion through financing and asset sales.

Ford is in slightly better shape. Although it used up $8 billion in cash during the first half of the year ($4.5 billion went on a one-off payment to a union-run health fund for retired workers), it has cash reserves of $26.6 billion. Its boss, Alan Mulally, has given up forecasting when the firm will return to profit, but Don Leclair, the chief financial officer, says he is confident that he has enough money to finance the recovery strategy. Critically, Ford's market share, unlike those of its Detroit rivals, seems to be stabilising, at around 14%.

As for Chrysler, who knows? The company insists its cash position is "stronger than planned", but that is hard to reconcile with a forecast from Edmunds.com, a popular website for car-buyers, that its unit sales will shrink by nearly a third this year.

In the race to restructure before the cash runs out, Ford looks best placed at the moment—a change from last year, when GM was in the lead. Both firms know that salvation lies in getting smaller cars to market quickly and selling them at premium prices. And both have access to attractive products built by their European divisions. But Ford is making more rapid progress. In July Mr Mulally said three of Ford's North American truck plants would switch to making small cars, at least four of which will come from Europe—new versions of the Fiesta, Focus, C-Max minivan and Kuga crossover. The Fiesta and Focus, Mr Mulally promised, will be coming off the lines within two years.

GM's global design chief, Ed Welburn, acknowledges that its next generation of small cars will be designed in places like South Korea and Europe where they "really know how to do small cars". But unlike Mr Mulally, Mr Wagoner has not said what will be arriving and when. Indeed, at times he seems weighed down by the sheer complexity of managing such a bloated product portfolio. On August 5th, after an annual review of product plans, Mr Wagoner, on whose five-year watch GM has lost some $70 billion, retained the support of his board. But decent and competent though he is, time may be running out for him even faster than it is for GM.

Advertising

Hello again, I'm Vista

Aug 7th 2008 | SAN FRANCISCO
From The Economist print edition

Microsoft hires a hot ad agency in an effort to improve its image

WERE advertisements rather than sales the yardstick, Apple would have dominated the computer industry for decades. First there was the legendary spot "1984", in that same year, which is often considered the best ad in history. Directed by Ridley Scott, then basking in "Blade Runner" fame, and produced by Chiat/Day, Apple's advertising agency to this day, it depicted Apple as the individualist and cool brand, in contrast to oppressive conformity, then understood to mean IBM.

Ever since then, the same man, Lee Clow, at what is now TBWA\Chiat\Day, part of Omnicom, a giant marketing group, has been socking it to Apple's bigger rival, Microsoft. His deadliest work yet is the current "Get a Mac" campaign—better known by its opening lines: "Hello, I'm a Mac—and I'm a PC." In the American version of the ad, a suave Mac, played by Justin Long, an actor, contrasts with a lovable but decidedly uncool PC, played by John Hodgman, a comedian who has been catapulted to celebrity as a result. The upshot, as ever: Apple's Mac types are elegantly effective; Microsoft's PC folks are bumbling plodders.

All this puts Microsoft in the awkward position of having its brand image defined by a rival—despite its own vast advertising budget, which towers above Apple's. But Microsoft has also made Apple's task a lot easier. It has made software that, by comparison with Apple's, is buggy and clunky. Most notoriously, Microsoft's latest operating system, Windows Vista, was first delayed for years, then launched to dreadful reviews and is now selling more slowly than expected, even after big price cuts.

So Microsoft is fighting back. A preliminary salvo, fired last month, was the so-called "Mojave Experiment"—a focus group in San Francisco of 140 volunteers who had not actually tried Vista but professed that they had heard awful things about it. They were then treated to ten-minute demos by a trained expert of a "new" operating system, allegedly called Mojave. They liked what they saw, and when told that this product was in fact Vista, they gasped in shock and delight. The climactic moments, naturally, are available for viewing at www.mojaveexperiment.com.

You could be forgiven for wondering whether Apple had commissioned the advertisement. It was Microsoft at its worst. The "experiment" addressed none of the problems with Vista—the trouble starts when ordinary consumers, not experts, try to use it with their existing hardware—and it felt as authentic as "reality" television.

But Microsoft is also preparing a much bigger attack. Earlier this year the firm caused a stir when it passed over its previous advertising agencies and chose Crispin Porter + Bogusky, arguably the hottest agency today, to put together a campaign rumoured to be costing $300m. Crispin's brief is to come up with an answer to Apple's campaign that does not feel reactive, and somehow makes Microsoft look cool.

By reputation, Crispin, based in Miami and Boulder, Colorado, might be the one agency that could pull off such a miracle. Its creative star is Alex Bogusky, though he has now risen to management level. In recent years, Crispin has revived, among other brands, Burger King, while coming up with admired campaigns for the Mini and Volkswagen. That said, there have also been flops, such as the baffling "Algorithm" campaign for Ask.com, which seemed to promote its larger rival Google.

Making Microsoft sexy is certain to be Crispin's biggest challenge yet, as its creative types are surely aware—since they, in line with the rest of their industry, overwhelmingly own and use Macs. But it may be possible. Apple's campaign has left itself vulnerable in at least one unforeseen way. Although everyone watching its spots agrees that Macs are cooler, most people also adore Mr Hodgman's PC. By contrast, Mr Long's Mac comes across as mildly but increasingly smug and irritating.

High seas, high prices

Aug 7th 2008 | HONG KONG
From The Economist print edition

How much will rising shipping costs hurt Chinese manufacturing?

ON LAND, high oil prices have ended America's love affair with sport-utility vehicles, forcing carmakers to revamp their product line-ups. In the air, sky-high fuel costs have prompted airlines to raise ticket prices and cut routes. What about at sea? Could rising shipping costs scupper China's export boom?

This question has been much discussed since Jeff Rubin and Benjamin Tal of CIBC, a Canadian bank, issued a memo a few weeks ago saying that a reversal of the great migration of manufacturing operations to China might already be under way. The cost of shipping a standard 40-foot container from Shanghai to America's east coast, for example, has jumped from $3,000 in 2000 to about $8,000 today. The extra cost of transporting goods halfway around the world, Messrs Rubin and Tal wrote, is wiping out the often slim margins of Chinese exporters. What is more, if oil and shipping prices stay high, many Western companies that now outsource their manufacturing to China might decide that it makes more sense to shift production closer to their customers at home.

Such scenarios would entail a huge shift in global trade patterns. Stephen Jen of Morgan Stanley, an investment bank, says higher shipping costs could even sound the death knell of the entire East Asian export model. This is because so many of the finished goods that China exports to America and Europe are made from components imported from Taiwan, Japan or South Korea. Clearly, affordable transport costs are an essential ingredient in this regional production matrix.

Exporters in China are certainly feeling the pain of higher shipping costs. The Transpacific Stabilisation Agreement bunker charge, a benchmark fuel surcharge imposed by shipping firms on sea freight, has risen from $455 per 40-foot equivalent unit in January 2007 to $1,130. Shipments to Europe face similar increases. In the first half of 2008 the growth rate of Chinese exports slowed to 21.9% from 27.6% a year earlier. In Guangdong province, the traditional heart of China's export manufacturing, growth plunged to 13% from 26.5%.

But if there is a migration of manufacturing from China, it is hardly an exodus. Even the latest trade figures do not show a fall in Chinese exports—only a drop in their pace of growth. And this can be attributed to a number of factors, including China's stronger currency (up almost 7% against the dollar this year), upward pressure on domestic wages, less generous Chinese government incentives for low-end exporters and weakening foreign demand.

There are already signs that Chinese officials are rethinking their "get tough" policy towards manufacturers of cheap goods. On August 1st the finance ministry increased export-tax rebates on a range of clothing products from 11% to 13%, and on bamboo products from 5% to 11%, in an apparent effort to help exporters of cheap goods. The closure of thousands of small factories is clearly worrying officials.

As for shipping costs, many companies in China export on a "free on board" basis. So theoretically it is the buyers on the other side of the ocean who must absorb the higher fuel surcharges on freight. Of course, they are forcing sellers to share some of the cost. But large bulk purchasers, such as Home Depot or Wal-Mart, are also squeezing the shipping companies to keep the overall bill down.

On balance, higher shipping costs are "not as big a factor" as the rising yuan or cost of raw materials, says an executive in the Shanghai office of an American building-materials company which exports Chinese-made goods to America, India and Australia. For a typical pair of Chinese-made shoes sold in America, shipping accounts for only 3-4% of the price.

Besides, companies will not find it easy to move their manufacturing out of China. Norman Cheng, co-founder of Strategic Sports, one of the world's largest motorcycle and bicycle helmet-makers, with two factories in Guangdong, says if he shifted production out of China, he would have to set up factories in his

two biggest markets, North America and Europe. Shipping costs would fall, but labour costs would rise and there would be fewer economies of scale.

So China's manufactured-export industry does not seem to be in imminent danger. Few companies will take the decision to leave China lightly, especially when no one knows if the price of oil will hit $200 or fall back to $100 in the coming months. A senior manager at a large Chinese electronics company, with four factories abroad, says higher shipping costs instead "give us urgency and an incentive to become significantly more efficient and competitive". Foreign and local firms can also divert production to China's fast-growing domestic market. There is no doubt that oil at $200 would have dire consequences, both for Chinese exporters and for other firms. But given the impact on the world economy, higher shipping costs might be the least of their worries.

Face value

A question of character

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What Kosaku Shima, Japan's most popular salaryman, says about Japanese business

Kenshi Hirokane-Kodansha Ltd



JAPANESE bosses are mostly an elderly lot. So it seemed that a new generation had taken the reins of corporate Japan when Kosaku Shima was appointed president of Hatsushiba Goyo, a conglomerate, in June. At just 60, Mr Shima is the best known and most beloved businessman in Japan. His ascent from lowly salaryman to lofty *shacho* (president) traces corporate Japan's rise in the 1980s, its descent into the "lost decade" of the 1990s and its subsequent tentative recovery. News of Mr Shima's appointment was broadcast on television and splashed across the country's newspapers, and the bosses of Japan's biggest firms lined up to lavish praise on him. "He is a man of principle," said Tsunehisa Katsumata, president of Tokyo Electric Power.

Part of Mr Shima's appeal, in addition to his timelessly youthful looks, is his respect for the Japanese virtues of hard work, self-sacrifice, loyalty and modesty. "My position is a result of the support of the people around me," he said when he was named to the post. Despite his modesty, Mr Shima has been the subject of two television series and a film. He endorses snacks and beer, so that pictures of him, perpetually raising a glass, are plastered across Japan. Ladies cannot help but throw themselves before him. He is rather like a Japanese James Bond who swapped 007 for an MBA. And Mr Shima resembles Mr Bond in another respect: he is a fictional character.

To be precise, Mr Shima is a *manga* (or cartoon) character. The comic books that have chronicled his career, drawn and written by Kenshi Hirokane since 1983, are hugely popular. Alongside improbable exploits and gratuitous sex, the books deal with serious themes and provide an unvarnished, realistic portrait of Japanese business. Middle managers are pushed into early retirement for daring to question the boss in a meeting; workers do not see their families for weeks as they are forced to remain at the office; managers are so wedded to their jobs that their wives divorce them; nasty office politics abound.

Yet in many ways Mr Shima is an unlikely choice to lead the fictional Hatsushiba. He made his reputation by taking risks, acting decisively, ruffling feathers and staying outside the factions vying for power. Such independent-minded individuals are anathema to corporate Japan and do not usually last long. During a stint managing Hatsushiba's record label, for example, Mr Shima pushed out stuffy managers who squandered money and obstructed his reforms. When running overseas affiliates, he criticised the way in

which Japanese firms like to send in Japanese managers; he promoted local staff instead, with much success. Mr Shima is, in other words, the antithesis of a Japanese executive. He is direct in his dealings, meritocratic, comes to his own conclusions, takes responsibility and embraces change. He is a leader in an environment hostile to leadership.

“Shima is influential—business people want to be like him but can’t,” says Yuko Kawamoto, a management professor at Waseda University who also sits on several company boards. But Mr Shima’s popularity is a positive sign, she believes. “Maybe there is hope for Japanese society. We want to change, but do not have the courage,” she says. For Mr Hirokane, the artist and author of the books, Mr Shima’s adventures are a way to inform as much as entertain. “Japan is really behind the rest of the world,” he says. “I want readers to know the critical situation of Japanese business in the world, and ask: 'What shall we do about it?'”

Mr Hirokane, with his silver cufflinks and gleaming wristwatch, is as dapper as the businessman he depicts. And he is cut from the same cloth. After earning a law degree, Mr Hirokane spent four years at Matsushita, a giant conglomerate, before becoming a *manga* artist—a radical career shift, particularly in Japan. But his success meant that life imitated art, and he emerged as a business savant. Mr Hirokane sits on government committees, interviews the bosses of big Japanese firms and spent a year as a professor of business ethics. Salaryman *manga* has been popular since the 1960s, but “Shima Kosaku” is the most adored, selling some 30m books. In Japan *manga* is a mainstream medium, with annual sales of ¥470 billion (about $4.5 billion).

Not on the curriculum vitae

Some of Mr Shima’s exploits raise questions about his suitability for his new role. He divorced his wife and all but ignored his family. He fathered an illegitimate child. In his 40s, as a rising executive, he had an affair with a subordinate 20 years his junior (who happened to be the daughter of the firm’s founder). More controversially, in 2002 Mr Shima solicited the help of the Chinese underworld to aid a colleague seeking revenge against a corrupt businessman, which resulted in that man’s torture and death.

In the 1990s the president of Hatsushiba sought to defend a former friend’s company that was under threat of a hostile takeover, and dispatched Mr Shima to spare no expense and buy up its shares. Mr Shima was venerated for his success. Yet his actions represented a blatant conflict of interest and a misuse of corporate funds. In the West, the pair would have faced shareholder lawsuits and possibly criminal charges. When confronted with this, a wide-eyed Mr Hirokane can only stammer that Mr Shima’s actions were probably allowed in Japan at the time.

As president, Mr Shima’s first message to his employees was “Think Global!” It was meant to set the tone of his tenure. But his very presence in the boss’s chair is improbable. His career has been defined by a willingness to break the rules of Japanese business, rather than play the game. His story is popular because it juxtaposes a dashing lifestyle with the unflattering reality of corporate Japan. It would have been more realistic if Mr Shima had been forced to end his career parked at an obscure affiliate company in the hinterland. With the ascension of the archetypal corporate rebel to the top job, Mr Shima’s story has gone from smart social realism to being just another fairy tale.

The credit crunch one year on

Mission creep at the Fed

Aug 7th 2008 | WASHINGTON, DC
From The Economist print edition

In a special section marking the anniversary of the credit crunch, we start with the Federal Reserve. Its creative response to the crisis may have staved off catastrophe, but may also have put its independence at risk

Getty Images



WHEN he was still in academia, Ben Bernanke once argued that Franklin Roosevelt's greatest contribution to ending the Great Depression was not a specific policy, but his "willingness to be aggressive and to experiment…to do whatever it took to get the country moving again." That would fairly describe how Mr Bernanke has battled perhaps the biggest financial crisis since FDR's time, which erupted one year ago this week.

The chairman of the Federal Reserve has cast aside any notion that central bankers should be boring. He has slashed interest rates; rolled out a dizzying array of new lending programmes; backed the debt of Bear Stearns, a failing investment bank; agreed to lend to Fannie Mae and Freddie Mac, America's troubled, quasi-private mortgage agencies; argued for fiscal stimulus and mortgage write-downs; and proposed an expansion of the Fed's regulatory domain.

The Fed did not seek its bigger role, but acted because no one else could. Mr Bernanke is now consumed with responsibilities he never imagined when he became chairman in early 2006. Since the crisis broke, he has been at his desk seven days a week, fuelled by cans of Diet Dr Pepper from a small refrigerator in his office. Even if his aggression and experimentation do not prevent a recession, they have softened the impact of falling house prices, rising default rates and the credit squeeze on America's economy. But they have also created new political risks for the Fed.

The central bank is lending to private companies on an unprecedented scale and is thus making decisions it long sought to avoid about the allocation of credit. It is also acquiring new powers of oversight. Politicians could chafe at the Fed's power: why, they might ask, should unelected officials choose who benefits from taxpayers' money? And they might press the central bank to pursue political ends—such as propping up favoured borrowers—that interfere with monetary policy.

Events beyond the Fed's control magnify these risks. Unemployment and inflation are likely to remain uncomfortably high for the next year or two; such a combination has fuelled political antagonism in the past. And the next president will have an instant opportunity to fill three seats on the Fed's seven-member board of governors (one is vacant; another soon will be; a third governor's term has expired). He and Congress will have a chance to shape the Fed's priorities on both regulation and monetary policy.

So far there is no congressional clamour to rein in the Fed, and Mr Bernanke thinks its monetary independence is safe. “We’ve been able to keep a good separation between monetary policy and these other areas,” he told Congress last month. But his predecessors worry, nonetheless. Paul Volcker urged Congress in May that if it wanted to prop up favoured sectors, it should do so transparently, not through the Fed. “That’s the way to destroy the Federal Reserve in the long run.” Alan Greenspan, in the paperback edition of his memoir, due out next month, makes a similar argument (see article).

Fed officials note that although they have acted in new ways, other central banks have done similar things. They point out that the European Central Bank (ECB) has long had the ability to lend against a wide variety of government and private collateral, as the Fed now does.

But the Fed’s independence is more tenuous than the ECB’s. The Federal Reserve Act is much easier to change than the Maastricht treaty. The Fed is also required to strive for both full employment and price stability, whereas stable prices are the ECB’s sole aim. Moreover, Americans traditionally are more suspicious than Europeans of giving any government body so much sway. In the first century of its existence the United States established two central banks, but closed them out of suspicion of such centralised power. The Fed, a blend of public and private authority, was set up only in 1913.

History suggests the Fed is especially vulnerable at times of economic turmoil. The Depression led to an overhaul that shifted power from its reserve banks to Washington, DC. The stagflation of the 1970s coincided with congressional efforts to take control of the Fed’s budget and the requirement that it seek both full employment and stable prices. The crisis that began a year ago may yet mark another turning-point in the relationship between America’s politicians and its central bank.

By far Mr Bernanke’s most innovative response to the credit crisis has been the expansion of the Fed’s tool kit from control of short-term interest rates to the deployment of its balance-sheet to restore liquidity to specific markets, such as that for inter-bank loans. A year ago 91% of the Fed’s assets were invested in government bonds. Now the share is 52%. Loans to banks and investment banks backed by a hotch-potch of collateral account for the difference (see chart 1).

Mr Bernanke often notes this simply returns the Fed to its roots as lender of last resort: it was created primarily to prevent financial panics. But now that its lending goes beyond the federal government, it faces fine judgments. To whom should it lend and on what terms? And how does it avoid becoming a crutch for markets that cannot stand up on their own?

Bernanke’s balance-sheet act 1
Treasury securities as % of the Fed’s total assets
Sources: Federal Reserve; Moody’s Economy.com

Politicians have asked the Fed to favour certain industries or keep interest rates low almost from its birth. In 1921 the Fed rejected requests from Congress to buy long-term agricultural debt. In the 1940s and again in the 1960s, under pressure from the Treasury, it bought bonds to hold down long-term interest rates. In the 1970s, at the behest of Congress, it bought the debt of federal agencies such as Fannie Mae and Freddie Mac.

A 2002 staff study pointed out the risks of favouring particular assets or borrowers: it could result in too much investment in preferred sectors and too little in others, drag the Fed into arguments about fiscal policy and compromise its monetary policy. In recent decades the Fed largely extracted itself from anything resembling credit allocation. The last of its Fannie bonds matured in 2003.

In the past year the current has begun to reverse. When the crisis first hit, Mr Bernanke’s first step was to lower the interest rate and lengthen the term on direct loans to banks from the Fed’s discount window. When banks were slow to respond, the Fed devised its “term auction facility” to make loans at the discount window cheaper and more anonymous (and therefore with less stigma for the borrowing bank). It was creative, but not radical: the Fed has always lent to banks, though seldom on such a scale, and the eligible collateral is the same. The facility is likely to become permanent.

Subsequent steps have strayed further from tradition. In March the Fed created a facility to swap up to $200 billion of its Treasuries for investment banks’ holdings of hard-to-trade mortgage-backed securities. A week later it took over $30 billion (later lowered to $29 billion) of Bear Stearns’ obligations to prevent a chaotic failure of the firm and enable its takeover by JPMorgan Chase. It also opened its discount window to investment banks, the first time since the Depression that non-banks had borrowed from that window. And in July it agreed to lend to Fannie Mae and Freddie Mac from the window should it “prove necessary”.

Although each step was a logical, targeted response to financial upheaval, the result was to prop up certain firms and markets.

Vincent Reinhart, a former Fed staffer now at the American Enterprise Institute, says it is ironic that the Fed named the special-purpose vehicle that holds the Bear Stearns assets Maiden Lane, after the street behind the Federal Reserve Bank of New York. The bail-out opened a back door to the Fed that makes it much harder to say no to similar pleas, he argues.

The pleas soon started coming. In April Chris Dodd, chairman of the Senate Banking Committee, demanded that the Fed permit top-rated securities backed by student loans to qualify for its $200 billion swap programme. “If the Fed and the treasury can commit $30 billion of taxpayer money to enable the takeover of Bear Stearns by JPMorgan Chase, then surely they can step in to enable working families to achieve the dream of a higher education for their children,” he declared.

Two weeks later the Fed said it would accept any AAA-rated securities as collateral, including those backed by student loans. Mr Dodd praised the decision. But Allan Meltzer, a Fed historian at Carnegie Mellon University, cringed, saying it looked as if the Fed had caved in to political pressure: “It gets close to the idea of credit allocation. And every Fed chairman without exception worried about that.”

Fed officials say the move was in the works before Mr Dodd spoke up. The central bank has turned down other entreaties, notably to buy mortgage-backed securities directly. Officials do not deny that some of their programmes move closer to credit allocation: that is why they were “designed to be self-liquidating as markets improve”, Donald Kohn, vice-chairman of the Fed, said in May.

However, self-liquidation is not imminent. On July 30th the Fed extended and expanded several of its programmes, for example extending investment banks’ access to the discount window until at least the end of January. In any event, the expiry of new arrangements will not restore the previous status quo. Vikram Pandit, Citigroup’s chief executive, said in June that “regardless of whether that window is officially opened or closed, the market now assumes that it will be opened if necessary on an ad hoc basis.”

Now that the Fed has extended public backing beyond banks to investment banks and the mortgage giants, it is likely, logically enough, to oversee the borrowers. But in expanding the Fed’s non-monetary duties, America is going against the international trend of recent years.

Central banks should be independent, the theory goes, because the power to spend money should be separate from the power to print it. By the same reasoning, many central banks have given up non-monetary tasks, such as bank supervision, because they involve more political judgments that could interfere with monetary policy. Hank Paulson, America’s treasury secretary, has advocated a similar arrangement, but the Bear Stearns episode upended the landscape.

The Fed’s new duties have not been formalised, but they will be greater, as will the potential for conflict over how it uses them. With these new duties, “it’s getting into areas that are not typically thought to require the degree of independence that monetary policy does,” Mr Volcker noted.

Although the Fed could make regulatory decisions less political, those decisions could also politicise the Fed. It could identify too closely with the firms it regulates, and err in favour of financial stability rather than price stability when the two are at odds. It could be drawn into contentious debates about how financial institutions should run themselves. And it may be blamed when the next crisis occurs. There is a precedent: in 1994 Congress gave the Fed broad authority to act against abusive mortgage loans. Democrats have repeatedly charged that the Fed’s failure to use those powers more energetically worsened the sub-prime crisis.

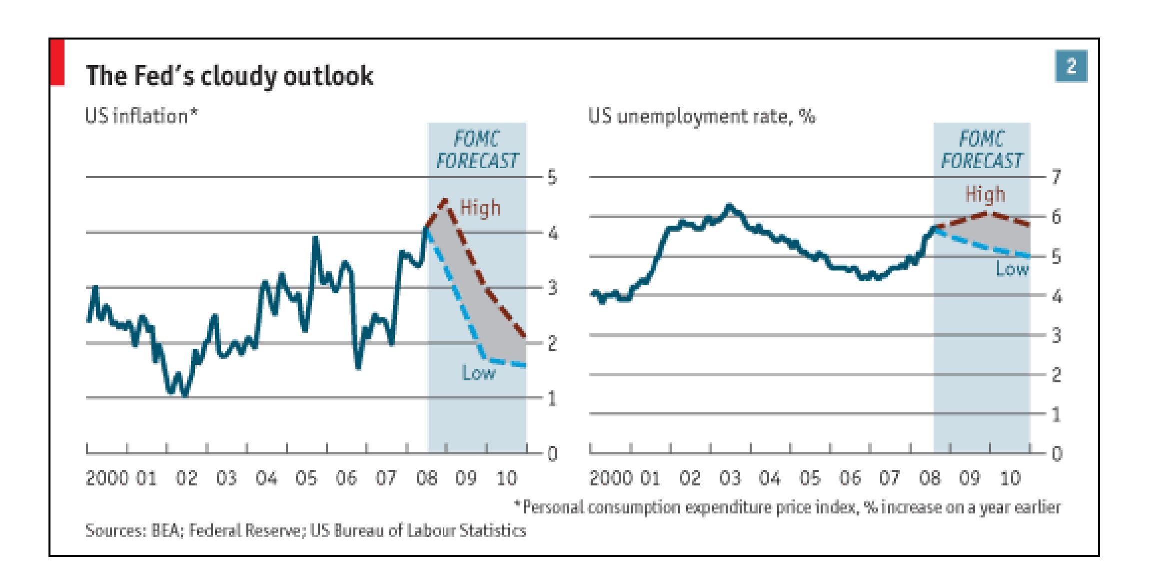
Ben Bernanke, policy wonk

As well as adding to the Fed’s policy tools and supervisory duties, Mr Bernanke has also waded into matters that do not involve the Fed directly, something for which Mr Greenspan was often criticised. At first Mr Bernanke sought to stay out of such debates. That has since changed, as he has supported fiscal stimulus and sweeping writedowns of troubled mortgages. He has also commented on exchange rates, a subject normally left to the Treasury.

Mr Bernanke’s interventions have, like his creative use of the Fed’s balance-sheet, taken some of the burden of economic stabilisation off interest rates. He has avoided endorsing specific controversial

proposals. It also helps that Democrats see him as prodding the executive branch towards action. His sharpest critics in Congress are conservative Republicans.

The risk, though, is that one day Mr Bernanke will have to take a view more at odds with the party in power. And that could happen when the economic circumstances are particularly testing. For the next year or two, the Fed is unlikely to achieve either full employment or price stability, if its forecasts are correct (see chart 2).



The Fed is in no hurry to tighten policy. On August 5th, when it held interest rates at 2%, it backtracked on its earlier optimism about growth, suggesting it would raise rates later rather than sooner. But if inflation expectations rise, it may have to increase rates while unemployment is unpalatably high. A similar set of circumstances in the early 1990s coincided with congressional efforts to strip reserve-bank presidents, who then as now were more hawkish than governors, of their votes on interest rates.

Ominously, this comes at a time when appointments to the Fed have become more politicised. Just as Republicans did when they controlled the Senate in the late 1990s, Democrats have refused to move on many of George Bush's recent nominations to the Fed, arguing that filling the empty seats is a job for the next president—even though governors have staggered, 14-year terms precisely to distance the Fed from the political cycle. Of the two presumptive presidential nominees, Barack Obama has, perhaps surprisingly, been more forthright than John McCain in supporting the independence of the Fed. (That may reflect the influence of Mr Volcker, who advises Mr Obama.)

Nevertheless, American politics are becoming more populist and interventionist, and the Fed may not be spared. What might be done to reduce these risks to the central bank? Consensus has emerged on one point: the need for clear responsibility when the failure of a financial institution threatens the entire economy. A formal procedure exists for bailing out an insolvent bank's depositors and then winding down the institution; Mr Bernanke and others favour something similar for investment banks. Mr Greenspan proposes a "standby panel of senior federal financial authorities" to determine when a failure is important enough to merit intervention.

But the job may inevitably fall to the Fed. "The Fed is the only agency that has the power to serve as a liquidity provider of last resort, a power that has proved critical in financial crises throughout history," Mr Bernanke noted last month. But whether that also means the Fed must remain a day-to-day supervisor, as he contends, is less clear. Moving those responsibilities, now shared by a patchwork of agencies, to a separate body, as Mr Paulson first proposed, could both rationalise America's regulatory structure and make the Fed a smaller political target.

The Fed itself could do more to ensure that its eventual mix of duties does not interfere with its commitment to price stability. Mr Bernanke has long said a numerical inflation target would be a safeguard of the Fed's independence: sacrificing the target to other priorities would demand explanation. When some colleagues balked at a target, he agreed to a compromise: policymakers would publish three-year economic forecasts, and their third-year inflation number would be a proxy target.

But the system is already showing its weaknesses. The energy-price shock forced officials to raise the third-year inflation forecast by a tenth of a percentage point in June, with none of the public debate a change in a target would have entailed. Frederic Mishkin, who is stepping down as a governor on August

31st, said recently that the Fed should publish forecasts for five or more years to make their preferred inflation rate more explicit and harder to abandon.

The Fed's creativity in the past year was justified; it stepped in when no other agency or political body could or would. But it should not ignore the risks it runs as a result. Among Roosevelt's actions during the Depression was an overhaul of the Fed's governance, making it more responsive to Washington. Mr Bernanke would no doubt prefer that this is one aggressive experiment that will not be repeated.

Alan Greenspan on financial turbulence

Hire the A-Team

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The former Fed chairman calls for a new way to deal with a crisis

AP



From Mr T to Mr G

A LIFELONG libertarian, Alan Greenspan does not ordinarily advocate giving the government more power. But he does so in a new epilogue to the paperback edition of his memoir, parts of which were made available to *The Economist*. The crisis of the past year has convinced him it is the lesser evil. Better someone else be in charge of bail-outs, he argues, than the Federal Reserve, which he led for 18 years.

Mr Greenspan says a high-level panel of American financial officials should be given broad power to seize any financial institution whose failure threatens the entire economy, bail out its creditors and close it down. “We need laws that specify and limit the conditions for bail-outs” and do so transparently with taxpayers’ money, “rather than circuitously through the central bank, as was done during the blow-up of Bear Stearns,” he writes in “The Age of Turbulence”. (Penguin is to release the paperback on September 9th.)

If that means the government has to wade in, so be it. “Our country has long since abandoned the notion that we should leave crises to be resolved solely by the marketplace,” he says. “The critical need…is to formalise…the procedures improvised in the case of Bear Stearns. This should ensure that in the future, government financial assistance to lending institutions does not impact the Federal Reserve’s balance-sheet and monetary policy.”

He says a standby panel, empowered by Congress, should determine if an institution’s failure is dangerous enough to require taxpayer support. It would then form a vehicle to take the firm into “conservatorship”, wipe out the equity, preferably impose a “haircut” on its debts before guaranteeing them, and then sell its assets. Mr Greenspan’s model is the Resolution Trust Corporation (on whose board he served), created in 1989 to take over failing thrifts, sell their assets, then close itself down. He pours cold water on a proposal by Hank Paulson, America’s treasury secretary, to give the Fed broad responsibility over market stability.

Mr Greenspan’s proposal may be politically difficult. For years Fannie Mae and Freddie Mac, America’s mortgage giants, resisted the creation of a regulator that could close them down. With other large institutions—be they investment banks, hedge funds or insurance companies—there might be even more of a fuss. And the Fed is not yet ready to bow out. “Unless I hear from Congress that I should not be responding to a crisis situation, I think that it’s a long-standing role of the central bank to use its lender-of-last-resort facilities,” Ben Bernanke, Mr Greenspan’s successor at the Fed, said last month.

Buttonwood

Fuel for thought

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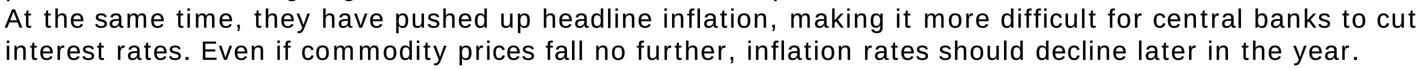
Despite lower commodity prices, there is still a lot to worry about


Illustration by S. Kambayashi

WHEN the credit crunch hit a year ago, the pessimists predicted a global recession. The optimists, by contrast, thought the rest of the world would be able to decouple from the problems of the American housing market.

Neither group really foresaw that the crunch would be accompanied by a soaring oil price. In a sense, high commodity prices have been the dark side of decoupling. But at last the picture has begun to change. Having touched $147 a barrel on July 11th, crude has dropped below $120. The Reuters/Jefferies CRB Commodity index fell 10% in July, the biggest monthly drop since March 1980. Gold has slipped below $900 an ounce, corn has fallen by more than 30% since early July and copper is at its lowest level in six months.

On balance, that is bullish for financial markets. Higher commodity prices have been weighing down consumers in the developed world. At the same time, they have pushed up headline inflation, making it more difficult for central banks to cut interest rates. Even if commodity prices fall no further, inflation rates should decline later in the year.



The crucial question is: why are commodity prices declining? If, as many people believe, the speculative froth is being taken out of the market, then all well and good. The only losers should be a few hedge funds.

But if commodity prices are declining because the global economy has hit a brick wall, that is another matter. The recent data have been distinctly downbeat, at least as far as Europe and Japan are concerned. Germany's GDP is reported to have dipped by as much as 1% in the second quarter. Retail sales in the euro zone fell by 3.1% in the year to June. British manufacturing output has been flat or falling for four months running. Industrial production in Japan has dropped for two consecutive quarters.

Although recent American economic data have been, on balance, slightly better than expected, a recession in Europe and Japan would imply a very gloomy outlook for corporate profits; after all, it has been export growth that has bolstered American manufacturers.

An alternative explanation might be that high oil prices have done their job. When demand for a product is fairly inelastic, a big price rise is needed to drive the marginal buyer out of the market. That buyer finally gave up when petrol passed $4 a gallon. According to the Department of Transportation, Americans drove 9.6 billion fewer miles in May than they did last year. At the same time as demand was shrinking, supply from the Organisation of the Petroleum Exporting Countries has risen in each of the last three months. In farming, supply and demand have come closer to balance, with export controls being lifted and better harvests expected.

All this uncertainty has made stockmarkets volatile. It has not helped that mining and energy stocks now have such big weights in the major indices; on August 5th energy stocks within the MSCI world index were 21% below their May high. But, after a fairly dismal June and July, there are signs that the mood is improving a little. Confirmation that the Federal Reserve will keep interest rates on hold for the time being helped the S&P 500 index rally by 2.9% on August 5th.

But it is hard to believe that stockmarkets will rally decisively without a lead from the credit markets, where the whole sorry tale began. Here, if one ignores the banking sector, there are some hopeful signs. Take the excess interest, or spread, on European non-financial debt rated investment grade. In June 2007 it was as low as 30.5 basis points (less than a third of a percentage point), according to Dresdner

Kleinwort. By April 1st it had almost quadrupled to 118 basis points. But it is now around a quarter of a percentage point below its peak.

The banks are a different story. In June 2007 European banks were paying just 63 basis points over government bonds. By the time of the Bear Stearns collapse in March, that spread had more than quintupled to 342.5 points. However, the peak did not occur until mid-July (thanks to the worries about Fannie Mae and Freddie Mac) and spreads are still only a few basis points below that high.

The danger, as Willem Sels of Dresdner points out, is a Phase II of the crunch, with bad-debt problems migrating from subprime mortgages to credit cards, auto loans and the leveraged loans issued by private-equity groups. Given their recent difficulties in raising capital, banks might react to further write-offs by being even more conservative in their lending, putting greater pressure on the economy. A year after the crunch began, the end is not yet clearly in sight.

Derivatives

Damoclean days

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From The Economist print edition

Huge risks remain in derivatives. There are ways to reduce them

OF ALL the newfangled financial creations that have caused problems this past year, arguably the most nerve-wracking are derivatives traded over-the-counter (OTC), or in private deals away from exchanges. The concerns are twofold: that the huge growth of these instruments has put the supporting infrastructure under strain, and that the failure of a big trader, or “counterparty”, to honour its commitments could cause chaos. Bear Stearns’s entanglement in credit-default swaps (CDSs) was the prime reason why regulators dared not countenance the Wall Street firm’s bankruptcy in March. With corporate defaults on the rise, the prospect of widespread counterparty woes “overhangs the market like a Damocles sword that is bound to fall”, George Soros, an outspoken investor, has opined.

Efforts to prevent catastrophe date back to 2005, when the Federal Reserve Bank of New York first banged dealers’ heads together over sloppy trade processing. The Bear Stearns debacle, and the expansion of the CDs market to more than $62 trillion in notional value, gave extra importance to making the system more resilient. Adding to the sense of urgency are the strains felt by bond insurers who had written CDS contracts for banks hoping to hedge their mortgage risks.

The biggest push yet to strengthen the market came on July 31st, when, at the Fed’s urging, major dealers set out ambitious goals to cut trading and settlement risks, mostly over the next six months. There was further acknowledgment of the need for change a few days later, with publication of a report by a group of senior bankers led by Gerald Corrigan, former head of the New York Fed.

Much progress has already been made. The backlog in trade confirmations, which spiked alarmingly last summer, has since been cut sharply; roughly half of all deals are now confirmed on the day they are made. The share of CDS trades conducted electronically, around 50% in 2005, is now above 90%. The dealers’ group has pledged to extend the work done in tidying up credit and equity derivatives to commodity, foreign-exchange and interest-rate contracts. Only half of all OTC interest-rate trades are automated.

Other areas of focus include trade settlement and “novation” (when one party replaces another as buyer or seller of protection). The dealers have promised to “hard-wire” cash settlement, rather than physical delivery of bonds, into standard documentation. Physical delivery could distort prices as defaults rise, because the value of CDS positions far exceeds the face value of the corporate debt they refer to. Novation is no less thorny. Buyers and sellers need to know promptly when the party on the other side of the trade changes, but they are being swamped, some with thousands of novation requests a day. There is new technology to solve this, from firms such as T-Zero. But progress is patchy.

Most eyes, however, are on the promise by 17 large dealers to launch a clearing-house for credit derivatives by the end of this year. As with an exchange-based clearer, this would act as a central counterparty, backed by a default fund, and thus greatly reduce the risk of any one player’s failure destabilising the system. And, by “netting” the trades it handles, the clearer could dramatically reduce the overall value of outstanding contracts.

This is primarily a response to regulatory pressure. But dealers have also become worried about the counterparty risks posed by their peers. By turning their market into a hybrid—centrally cleared but still privately negotiated—they hope to make it more robust while safeguarding the fat spreads they earn by hawking OTC products. Exchanges, such as Chicago’s CME, are vying for a share of the market.

Many contracts will inevitably gravitate towards exchanges: index-based CDSs are becoming increasingly standardised. But demand for customised contracts is likely to remain heavy because many like the anonymity, points out Darrell Duffie of Stanford University. All the more reason to find ways, quickly, to blunt that sword.

Bank losses

Hall of shame

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Many bank bosses should count themselves lucky still to be in a job

BANKING sells itself as a cut-throat industry, lavish in its rewards but steadfast in its treatment of underperformers. A year into the credit crisis, it has too often been steadfast in its rewards and lavish in its approach to failure.

The three banks that have suffered the heftiest losses since credit first crunched—Citigroup, Merrill Lynch and UBS—have all swept out the old management since their problems surfaced. But of the ten banks to have spilt the most red ink over the past year (see table), five have the same chief executives in place.

Some can muster decent arguments for continuity. HSBC, which reported its first-half results on August 4th, has taken heavy losses but is strongly capitalised and well diversified; its shares have been a rare haven for bank investors. Bank of America can justifiably claim to have stood back from the worst excesses of America's mortgage-lending boom.

Loss leaders

Performance since August 9th 2007

	Write-downs and losses, $bn	Fate of CEO	% fall in share price
Citigroup	54.6	Replaced	-58
Merrill Lynch	51.8	Replaced	-62
UBS	38.2	Replaced*	-63
HSBC	27.4	Survived	-6
Wachovia	22.0	Replaced	-61
Bank of America	21.2	Survived	-31
IKB	15.9	Replaced	-83
Royal Bank of Scotland	15.2†	Survived	-53
Washington Mutual	14.8	Survived	-86
Morgan Stanley	14.4	Survived	-30

Sources: Bloomberg; Thomson Datastream; company reports

*July 2007 †Before first-half 2008 results

Other bosses have fewer hiding-places. Royal Bank of Scotland, which was expected to unveil further losses on August 8th, finalised the costly acquisition of ABN AMRO, a Dutch bank, after the crunch had started. Its boss, Sir Fred Goodwin, is widely thought to be living on borrowed time. Washington Mutual, a Seattle-based thrift, has suffered the largest share-price decline of the ten. Kerry Killinger did enough damage to lose his role as chairman in June but not, apparently, enough to lose his position as chief executive. John Mack retains both roles at Morgan Stanley despite some sloppy risk management.

Stories of survival spread far beyond the top ten. It appears particularly hard to get the sack from British banks. The bosses of Fannie Mae and Freddie Mac, America's limping mortgage giants, continue to draw handsome salaries. Firing people does not guarantee success: signs of impatience with new brooms like John Thain at Merrill are now visible. But it ought to be the price of failure.



FINANCE & ECONOMICS

A personal view of the crisis

Confessions of a risk manager

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From The Economist print edition

Why did banks become so overexposed in the run-up to the credit crunch? A risk manager at a large global bank—someone whose job it was to make sure that the firm did not take unnecessary risks—explains in his own words

Gary Neil



IN JANUARY 2007 the world looked almost riskless. At the beginning of that year I gathered my team for an off-site meeting to identify our top five risks for the coming 12 months. We were paid to think about the downsides but it was hard to see where the problems would come from. Four years of falling credit spreads, low interest rates, virtually no defaults in our loan portfolio and historically low volatility levels: it was the most benign risk environment we had seen in 20 years.

As risk managers we were responsible for approving credit requests and transactions submitted to us by the bankers and traders in the front-line. We also monitored and reported the level of risk across the bank's portfolio and set limits for overall credit and market-risk positions.

The possibility that liquidity could suddenly dry up was always a topic high on our list but we could only see more liquidity coming into the market—not going out of it. Institutional investors, hedge funds, private-equity firms and sovereign-wealth funds were all looking to invest in assets. This was why credit spreads were narrowing, especially in emerging markets, and debt-to-earnings ratios on private-equity financings were increasing. "Where is the liquidity crisis supposed to come from?" somebody asked in the meeting. No one could give a good answer.

Looking back on it now we should of course have paid more attention to the first signs of trouble. No crisis comes completely out of the blue; there are always clues and advance warnings if you can only interpret them correctly. It was the hiccup in the structured-credit market in May 2005 which gave the strongest indication of what was to come. In that month bonds of General Motors were marked down by the rating agencies from investment grade to non-investment grade, or "junk". Because the American carmaker's bonds were widely held in structured-credit portfolios, the downgrades caused a big dislocation in the market.

Like most banks we owned a portfolio of different tranches of collateralised-debt obligations (CDOs), which are packages of asset-backed securities. Our business and risk strategy was to buy pools of assets, mainly bonds; warehouse them on our own balance-sheet and structure them into CDOs; and finally distribute them to end investors. We were most eager to sell the non-investment-grade tranches, and our risk approvals were conditional on reducing these to zero. We would allow positions of the top-rated AAA and

super-senior (even better than AAA) tranches to be held on our own balance-sheet as the default risk was deemed to be well protected by all the lower tranches, which would have to absorb any prior losses.

In May 2005 we held AAA tranches, expecting them to rise in value, and sold non-investment-grade tranches, expecting them to go down. From a risk-management point of view, this was perfect: have a long position in the low-risk asset, and a short one in the higher-risk one. But the reverse happened of what we had expected: AAA tranches went down in price and non-investment-grade tranches went up, resulting in losses as we marked the positions to market.

This was entirely counter-intuitive. Explanations of why this had happened were confusing and focused on complicated cross-correlations between tranches. In essence it turned out that there had been a short squeeze in non-investment-grade tranches, driving their prices up, and a general selling of all more senior structured tranches, even the very best AAA ones.

That mini-liquidity crisis was to be replayed on a very big scale in the summer of 2007. But we had failed to draw the correct conclusions. As risk managers we should have insisted that all structured tranches, not just the non-investment-grade ones, be sold. But we did not believe that prices on AAA assets could fall by more than about 1% in price. A 20% drop on assets with virtually no default risk seemed inconceivable—though this did eventually occur. Liquidity risk was in effect not priced well enough; the market always allowed for it, but at only very small margins prior to the credit crisis.

So how did we get ourselves into a situation where we built up such large trading positions? There were a number of factors. As is often the case, it happened so gradually that it was barely perceptible.

Fighting the last war

The focus of our risk management was on the loan portfolio and classic market risk. Loans were illiquid and accounted for on an accrual basis in the “banking book” rather than on a mark-to-market basis in the “trading book”. Rigorous credit analysis to ensure minimum loan-loss provisions was important. Loan risks and classic market risks were generally well understood and regularly reviewed. Equities, government bonds and foreign exchange, and their derivatives, were well managed in the trading book and monitored on a daily basis.

The gap in our risk management only opened up gradually over the years with the growth of traded credit products such as CDO tranches and other asset-backed securities. These sat uncomfortably between market and credit risk. The market-risk department never really took ownership of them, believing them to be primarily credit-risk instruments, and the credit-risk department thought of them as market risk as they sat in the trading book.

The explosive growth and profitability of the structured-credit market made this an ever greater problem. Our risk-management response was half-hearted. We set portfolio limits on each rating category but otherwise left the trading desks to their own devices. We made two assumptions which would cost us dearly. First, we thought that all mark-to-market positions in the trading book would receive immediate attention when losses occurred, because their profits and losses were published daily. Second, we assumed that, if the market ran into difficulties, we could easily adjust and liquidate our positions, especially on securities rated AAA and AA. Our focus was always on the non-investment-grade part of the portfolio, especially the emerging-markets paper. The previous crises in Russia and Latin America had left a deeply ingrained fear of sudden liquidity shocks and widening credit spreads. Ironically, of course, in the credit crunch the emerging-market bonds have outperformed the Western credit assets.

We also trusted the rating agencies. It is hard to imagine now but the reputation of outside bond ratings was so high that if the risk department had ever assigned a lower rating, our judgment would have been immediately questioned. It was assumed that the rating agencies simply knew best.

We were thus comfortable with investment-grade assets and were struggling with the huge volume of business. We were too slow to sell these better-rated assets. We needed little capital to support them; there was no liquidity charge, very little default risk and a small positive margin, or “carry”, between holding the assets and their financing in the liquid interbank and repo markets. Gradually the structures became more complicated. Since they were held in the trading book, many avoided the rigorous credit process applied to the banking-book assets which might have identified some of the weaknesses.

The pressure on the risk department to keep up and approve transactions was immense. Psychology

played a big part. The risk department had a separate reporting line to the board to preserve its independence. This had been reinforced by the regulators who believed it was essential for objective risk analysis and assessment. However, this separation hurt our relationship with the bankers and traders we were supposed to monitor.

Spoilsports

In their eyes, we were not earning money for the bank. Worse, we had the power to say no and therefore prevent business from being done. Traders saw us as obstructive and a hindrance to their ability to earn higher bonuses. They did not take kindly to this. Sometimes the relationship between the risk department and the business lines ended in arguments. I often had calls from my own risk managers forewarning me that a senior trader was about to call me to complain about a declined transaction. Most of the time the business line would simply not take no for an answer, especially if the profits were big enough. We, of course, were suspicious, because bigger margins usually meant higher risk. Criticisms that we were being “non-commercial”, “unconstructive” and “obstinate” were not uncommon. It has to be said that the risk department did not always help its cause. Our risk managers, although they had strong analytical skills, were not necessarily good communicators and salesmen. Tactfully explaining why we said no was not our forte. Traders were often exasperated as much by how they were told as by what they were told.

At the root of it all, however, was—and still is—a deeply ingrained flaw in the decision-making process. In contrast to the law, where two sides make an equal-and-opposite argument that is fairly judged, in banks there is always a bias towards one side of the argument. The business line was more focused on getting a transaction approved than on identifying the risks in what it was proposing. The risk factors were a small part of the presentation and always “mitigated”. This made it hard to discourage transactions. If a risk manager said no, he was immediately on a collision course with the business line. The risk thinking therefore leaned towards giving the benefit of the doubt to the risk-takers.

Collective common sense suffered as a result. Often in meetings, our gut reactions as risk managers were negative. But it was difficult to come up with hard-and-fast arguments for why you should decline a transaction, especially when you were sitting opposite a team that had worked for weeks on a proposal, which you had received an hour before the meeting started. In the end, with pressure for earnings and a calm market environment, we reluctantly agreed to marginal transactions.

Gary Neil



Over time we accumulated a balance-sheet of traded assets which allowed for very little margin of error. We owned a large portfolio of “very low-risk” assets which turned out to be high-risk. A small price movement on billions of dollars’ worth of securities would translate into large mark-to-market losses. We thought that we had focused correctly on the non-investment-grade paper, of which we held little. We had not paid enough attention to the ever-growing mountain of highly rated but potentially illiquid assets. We had not fully appreciated that 20% of a very large number can inflict far greater losses than 80% of a small number.

Goals and goalkeepers

What have we, both as risk managers and as an industry, to learn from this crisis? A number of thoughts come to mind. One lesson is to go back to basics, to analyse your balance-sheet positions by type, size and complexity both before and after you have hedged them. Do not assume that ratings are always correct and if they are, remember that they can change quickly.

Another lesson is to account properly for liquidity risk in two ways. One is to increase internal and external capital charges for trading-book positions. These are too low relative to banking-book positions and need to be recalibrated. The other is to bring back liquidity reserves. This has received little attention in the industry so far. Over time fair-value accounting practices have disallowed liquidity reserves, as they were deemed to allow for smoothing of earnings. However, in an environment in which an ever-increasing part of the balance-sheet is taken up by trading assets, it would be more sensible to allow liquidity reserves whose size is set in scale to the complexity of the underlying asset. That would be better than questioning

the whole principle of mark-to-market accounting, as some banks are doing.

Last but not least, change the perception and standing of risk departments by giving them more prominence. The best way would be to encourage more traders to become risk managers. Unfortunately the trend has been in reverse; good risk managers end up in the front-line and good traders and bankers, once in the front-line, very rarely go the other way. Risk managers need to be perceived like good goalkeepers: always in the game and occasionally absolutely at the heart of it, like in a penalty shoot-out.

This is hard to achieve because the job we do has the risk profile of a short option position with unlimited downside and limited upside. This is the one position that every good risk manager knows he must avoid at all costs. A wise firm will need to bear this in mind when it tries to persuade its best staff to take on such a crucial task.

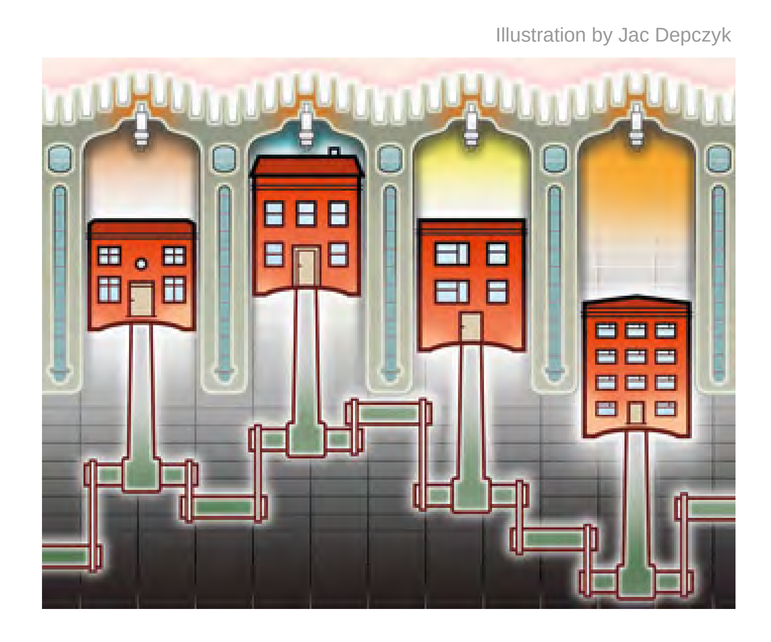
Economics focus

Home truths

Aug 7th 2008
From The Economist print edition

A housing slump helped cause the credit crisis. But its effect on spending may have been exaggerated

Illustration by Jac Depczyk



FALLING house prices have been at the heart of the rich world's economic troubles in the past year. They led to the surge in defaults on American subprime mortgages that poisoned the market for asset-backed securities and drove up inter-bank rates. Mortgage-related losses have made international banks wary of lending to even creditworthy borrowers. The drying-up of credit has meant fewer buyers for new homes, leading to construction busts in America, Spain and Ireland. Now even countries unaffected by the global housing boom, such as Germany and Japan, are suffering from weaker export demand.

In America the tangible impact of the housing slump is plain to see in the number of empty homes and in rising unemployment. There is greater uncertainty about the indirect effects of falling house prices, including the extent to which consumer spending will be held back by the "wealth effect". Spending is largely driven by how much people earn in real terms today, but it is also affected by expectations about incomes tomorrow. An important part of future incomes is tied up in the assets—stocks, bonds, property—where household wealth is stored. When asset values fall, those who own them are poorer, hence they spend less and save more. When wealth increases, they spend more.

An OECD study in 2004 put the marginal propensity to spend out of financial wealth at between 0.01 and 0.07 for rich countries: that is, if wealth rises by $1, spending rises by between one and seven cents. The Federal Reserve's model puts the wealth effect in America at 0.0375.

The Fed's model assumes the same wealth effect for housing as for financial assets. From the perspective of lifetime income, a dollar of housing wealth is the same as a dollar of stockmarket wealth. But some argue that the negative wealth effect from falling home values may be larger than for other assets. One reason is that housing wealth is spread more evenly than financial wealth, which is concentrated among rich households whose spending is less sensitive to the changing tides. Another is that housing slumps are rarer than stockmarket downturns. Consumers are likely to consider a fall in house values as a durable change in wealth and may cut spending more sharply in response.

Alternatively some, such as Willem Buiter, a former member of the Bank of England's monetary-policy committee, believe there is no wealth effect from housing at all. In a provocatively titled new paper* Mr Buiter, now at the London School of Economics, argues that "Housing Wealth Isn't Wealth". The title, he admits, is a device to capture the attention of readers. It is not strictly true: the housing stock is valuable

because of the shelter it provides now and in the future. The more housing we have, the wealthier we are. Mr Buiter's point is that there is no wealth effect from falling house prices, because while there are winners and losers, the average consumer is no worse off. It is, he says, an idea that was first put to him a decade ago by Mervyn King, now governor of the Bank of England.

A shift in the value of housing does not affect household wealth in the aggregate, he says, because on average everyone is a tenant in his own home. A price fall hurts those who are "long" housing assets, ie, those who own more property than they will need over their lifetime (call them landlords). It benefits those who are "short" housing, ie, those who plan to buy a property or to trade up to a bigger one in the future (call them tenants). The average experience is of an owner-occupier who plans to live in his home until he dies. Unless he worries about how much he will leave to his heirs, he is indifferent to the value of his home.

Changes in house prices shift the distribution of household wealth: they do not alter it, says Mr Buiter. Yet in his schema, there is an exception to the rule: should prices fall because of a bubble bursting, then there is a wealth effect. Landlords are worse off because they lose the bubble value—the part that did not reflect fundamentals. But tenants are no better off, because the present cost of future housing services is unchanged.

A fall in overall housing wealth might still affect spending if the housing-rich and housing-poor respond with different force to their respective fortunes. Homeowners are very likely to register the effect of their loss of wealth and to cut back on spending. The gain to renters and those wishing to trade up in the housing market is less tangible and may not affect consumer spending as much. Mr Buiter is rather sceptical about this argument. Young people saving hard for a first property or to buy a bigger home have more licence to spend freely when house prices fall, he says.

When the cash machine stops working

Falling housing wealth might also crimp spending by restricting access to credit. Banks are happier to lend against collateral. For many households, their homes are the only form of wealth they can offer as security. A fall in house values means there is less scope for running down home equity to prop up consumption.

Mr Buiter agrees that this is an important channel through which falling house prices might hurt spending. His concern is that judgments about the impact of America's housing bust, including those of a number of senior Fed officials, assume a downward effect from restricted credit over and above what would normally—though erroneously in his view—be the wealth effect. To him, this is double counting the negatives. It means "the Fed may have been convinced to cut rates too fast and too far."

There is a also a more general point that emerges from Mr Buiter's paper. Very often there is too much emphasis on the losers from falling house prices and too little on the winners. A fall in house prices is not bad for everybody. In an important sense, a house is much like any other durable good: a fall in prices is a boon for those consumers who have yet to buy one.

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*NBER working paper No. 14204 (July 2008).

Correction: Meinl Bank

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From The Economist print edition

In our article on Meinl Bank last week ("Pulling the wool") we said that Julius Meinl V was the head of the Meinl family. He is not. He is the head of the financial-services arm of the family business. Sorry. This error has been corrected online.

 FINANCE & ECONOMICS

Clarification: XL Capital Assurance

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In the issue of August 2nd 2008, the company with which Merrill Lynch recently settled a hedging dispute ("Thain takes the pain") is XL Capital Assurance, not XL Capital Ltd. The article has been changed online.

The XVIIth International AIDS Conference

Win some, lose some

Aug 7th 2008 | MEXICO CITY
From The Economist print edition

Illustration by Ian Whadcock



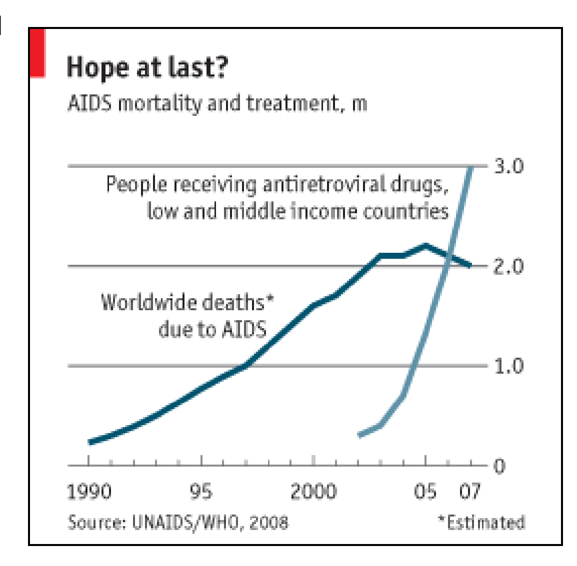
The battle against AIDS is becoming a war of attrition. Which side is on top is not yet clear

IF MONEY is the sinews of war, as Cicero suggested, then it is always good to have America on your side. America bankrolled the second world war, and it looks as though it is going to bankroll the war on AIDS, too. On July 30th George Bush signed an act reauthorising PEPFAR, the President's Emergency Plan for AIDS Relief. It provides for $39 billion to be spent on AIDS over the next five years, up from $15 billion for the past five. It was a welcome backdrop to the XVIIth International AIDS Conference, held this week in Mexico. Mr Bush has been on the receiving end of a lot of flak from AIDS activists for imposing conditions on the way PEPFAR's budget is disbursed—preferring chastity to condoms, for example—but, overall, he has been a force for good in the field of AIDS. PEPFAR was his own idea and, as the old saying has it, he who pays the piper calls the tune. In that context $39 billion is a positive symphony.

There is also good news elsewhere. The latest report from UNAIDS, the United Nations agency charged with combating the disease, was released on July 29th. It suggests that the death rate from AIDS is now falling. It peaked in 2005 at 2.2m a year. Now it is down to 2m, thanks to the torrent of money that is providing patients in poorer parts of the world with drugs that keep HIV, the virus that causes the disease, under control (see chart). Of course there are critics, too. The aim was to provide such drugs to all who need them by 2010. This was always going to be a tall order. The target has not been formally abandoned. But Stephen Lewis, a former UN special envoy for HIV/AIDS in Africa, says that a close reading of the report suggests its authors no longer believe in the deadline. Mr Lewis reckons the activists are being softened up for a slippage to 2015.

That would be a disappointment. And there have been several of those since the last conference, two years ago in Toronto. Then the talk was of new forms of prevention—in particular, of vaginal microbicides that would stop women getting infected; of the suppression of genital herpes, which is thought to help HIV get into the body; and even of pressing the good old contraceptive diaphragm into use to block the virus. But three trials of microbicides have now failed, and so have two herpes-suppression trials and one trial of diaphragms. As for vaccines, the shimmering hope on the horizon of every AIDS conference, the one big trial to report has more than just failed; for many of the participants the vaccine seemed to make things worse. The consensus among vaccine researchers now seems to be that future trials should be abandoned and the money saved spent on basic science.

On top of all this gloom, it is still the case that nobody has the faintest clue how to cure someone once they have been infected with HIV. The drugs, welcome as they are, merely stave off the immune-system crash that opens the victim to lethal secondary infections such as tuberculosis. That means you have to stay on them for life. As a result, taxpayers are accumulating an indefinite—and indefinitely growing—responsibility for keeping people alive. Somehow, somebody has to work out how to stop the disease spreading.



The pill or the snip?

Oddly, one possible way of making a big dent in the problem has been sitting under people's noses for years. Anti-retrovirals, or ARVs, as the drugs used to treat AIDS are known, work by stopping HIV from breeding. They do not cure, because there are places in the body that the virus can hide from them. But while someone is taking the drugs, the virus almost disappears from his blood stream—and, crucially, his seminal fluid. Moreover, if the infected individual is a she, rather than a he, the drugs have a tendency to accumulate in the tissue of the vagina.

Those observations are leading in three directions. The first is the idea of pre-exposure prophylaxis—in other words, giving ARVs to uninfected people to clobber any new infection before it can get going. Two trials of this approach will report next year.

The second is to use ARVs as microbicides. The unsuccessful microbicide trials used either long, complicated molecules intended to act as a physical barrier to the viruses or detergents to disrupt them. ARVs in the vagina might stop them breeding before they get into the body.

The third approach, though, is the most intriguing. This is to do nothing more than press ahead faster with the treatment programme. Since treatment reduces viral load, it should, in theory, make those being treated less infectious. Of course, theory is one thing and practice another. But studies in Taiwan and British Columbia (the latter by Julio Montaner, the incoming president of the International AIDS Society, which organises the conference) have shown big falls in transmission rates as ARVs have been rolled out. Meanwhile, Myron Cohen, of the University of North Carolina, Chapel Hill, is beginning a clinical trial involving 1,750 "discordant" couples (those in which one partner is infected and the other not) to see if ARVs really do reduce transmission. This trial will not report for seven years, but Dr Montaner hopes the mere likelihood that treatment also prevents transmission will spur governments to redouble their efforts to roll out ARVs and thus obtain a prevention programme at no additional cost.

It was this sort of careful science—starting with a scientific hypothesis, following it up with observations in the field and ending with clinical trials—which proved that circumcision protects against infection. Indeed, amid the gloom about microbicides and vaccines, circumcision is the one bright spot in the field of AIDS prevention. Most forms of prevention have to be pushed on to people. But there are already parts of Africa, including South Africa, Swaziland and Zambia, where men are queuing up to have their foreskins cut off. The scientific basis of all this is that foreskin tissue is rich in a particular sort of cell that HIV likes very much. The field observation is that, within Africa, one of the two best predictors of the intensity of the epidemic in any given place is the prevalence of circumcision. The clinical trials suggest that circumcision by itself reduces a man's chance of becoming infected by 50-60%. The upshot, according to Brian Williams of the World Health Organisation, is that if, in some ideal world, every sexually active man in sub-Saharan Africa were circumcised, 2m new infections would be avoided over the course of ten years, and 300,000 deaths prevented.

The demand for circumcision seems to have caught everybody off guard. Some surprising people disapprove of the whole idea. Yoweri Museveni, the president of Uganda, who is normally at the forefront of the anti-AIDS movement, has spoken out against it on the grounds that it might encourage men to become more promiscuous (although that does not seem to have been true of participants in clinical trials). And members of some groups who traditionally circumcise boys or teenagers as a mark of group

membership seem equivocal about the idea of outsiders adopting the practice. But the main constraint is the lack of enough people trained to wield the knife cleanly and safely. Indeed, Tachi Yamada, the head of the Gates Foundation's Global Health Programme, suggests bringing in volunteers from the rich world on a temporary basis, to clear the backlog.

The other predictor of the scale of the epidemic in African countries, besides rates of circumcision, requires a rather different approach. It is the rate of what are known, delicately, as concurrent partnerships. That is, how many lovers the average individual has at any one time. In this case, changing people's behaviour involves pushing very hard indeed.

Every home should have one

Behavioural change is, in some ways, prevention's orphan. The chiding voice saying "use a condom" or, worse, "don't have sex with anyone other than your regular partner", is not what most people want to hear. But, according to Helene Gayle, co-chairman of the Global HIV Prevention Working Group, which has been investigating the matter, no national epidemic has been brought under control without it.

One reason for the orphan status of behaviour change is that it is seen as slightly unscientific. Dr Gayle and her colleagues are trying to change that. They have been looking at research in the field and discovered a lot of trials that attempt to borrow the methodology of medicine by using control groups. These trials quantify everyday experience and, in the round, suggest that campaigns to promote condom use, to curb promiscuity and to promote the use by drug takers of clean needles can reduce infection rates in the groups they are aimed at by 20-30%. Not, perhaps, as impressive as foreskin-amputation, but certainly a worthwhile improvement.

Peter Piot, the head of UNAIDS, thinks that much more could be done in this area. Social science, even when it emphasises the "science" over the "social", can only achieve so much. Sometimes, you just have to bring in the professionals. To that end, he and his colleagues have already had informal talks with marketing experts from Procter & Gamble about getting the message over in a subtle and effective manner. Marketing people also understand that markets vary, and tailor their message accordingly.

That is something that the AIDS establishment has been bad at until recently. Many countries whose epidemics have been concentrated among gay men or injecting drug users, or where prostitutes have been the centres of infection, have preferred to pretend such people did not exist and have spent money preaching to heterosexuals who are at low risk. Conversely, in places where most infected people are part of the wider population, blind eyes have been turned to the reality of the way the disease spreads heterosexually. Some countries have played down the question of concurrent partnerships, a particular cause of trouble in parts of Africa. There has also been a widespread assumption that, among married couples, the promiscuous partner is likely to be the man. Studies of discordant couples show that to be so, but much less than had been assumed. Though the data are limited, they suggest that in about a third of discordant African couples it is the woman, not the man, who is infected.

The other thing people who work on AIDS have been bad about is championing this or that prevention strategy over the rest. The pro-condom versus pro-abstinence argument is a good example of that. But if one lesson has come out of the meeting, it is that you need every weapon you can lay your hands on.

It is particularly odd that this was not noticed before, since the tremendous success of ARVs comes from using several of them in combination. The watchword now is "combination prevention" to go along with combination therapy. If AIDS is to be beaten back without a vaccine—which is still a big if—that is the only sensible way forward. Wars, however well financed, are won by disciplined bodies of troops, not rabbles.



SCIENCE & TECHNOLOGY

Forensic technology

Sticky fingers

Aug 7th 2008
From The Economist print edition

A new and more powerful fingerprinting technology is at hand

AS ANY aficionado of whodunnits will know, lifting and analysing fingerprints is a tedious task. Fiddling with the little brushes, fine powders and sticky tape can test the patience of the most fastidious crime-scene investigator. And then there is all the lab work, which can require even greater care. However, real-life forensic experts may soon look less like their counterparts in “CSI” and more like sci-fi sleuths armed with extremely clever hand-held fingerprint analysers.

This could be the upshot of a new fingerprinting method developed by Demian Ifa and his colleagues at Purdue University in Indiana. Their innovation, reported this week in *Science*, is based on desorption electrospray ionisation (DESI), an analytical technique which can be deployed in the field. It involves spraying a tiny (0.15x0.15mm) area of a fingerprint with an electrically charged mixture of methanol and water. When these charged droplets come into contact with the surface of the print they collect any substances deposited on it, creating a thin liquid film. As more drops are sprayed on the same spot, some of this film is scattered and sucked into a mass spectrometer, which can identify the molecules collected. All this takes only a few tenths of a second. Then the spray is moved along to the next patch on the fingerprint and the process is repeated. It will work on any surface on which there are fingerprints.

Each reading by the mass spectrometer creates a kind of chemical “pixel”. However, instead of each pixel representing a colour, as in the image on a screen, these readings show all the different chemical compounds present in each of the thousands of tiny patches that together make up the sample. The overall distribution of these readings can be converted into an image of the fingerprint that is accurate enough to identify who left it with standard recognition software.

But DESI also presents an additional boon to gumshoes. Because it is based on chemical rather than purely visual data, it can discover what else people touched before leaving their prints. In their experiments, Dr Ifa and his team identified minute traces of drugs, such as cocaine and marijuana, as well as explosives.

Moreover, besides indicating what substances had been deposited on the skin of the person who left the print, DESI can discern traces of substances that have been secreted through it. Since such secretions are the end result of chemical processes going on inside the body, they can provide indirect evidence of a person’s health, which could also help with identification. One day such techniques may even help doctors diagnose illnesses by scanning a portion of the skin of their patients.

Given that different people tend to handle different things (and not necessarily illicit ones), and that they secrete slightly different substances, this method can even help to disentangle overlapping sets of fingerprints, which is very difficult with optical analysis alone. Graham Cooks, a member of the Purdue team, has already built a functioning portable DESI device with a built-in miniature mass spectrometer that is no bigger than a doctor’s case. With such technology virtually at policemen’s fingertips, crooks are well advised to keep their hands clean.

Solar power

Glowing after dark

Aug 7th 2008
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Looking to leaves for a way to store solar power after sunset

PLANTS absorb sunlight, produce energy, consume carbon dioxide and exhale oxygen. It is a perfect model for power generation, but copying Mother Nature is difficult. Although research into solar power has come a long way, sunset still poses a problem. Storing solar-made electricity in batteries can be expensive and inefficient. So to be really successful, the solar industry needs another way to keep power for use at night. Now researchers have found a chemical cocktail that might do the trick.

By adding cobalt and phosphates to water and passing a mild current through the solution with a glass electrode, Matthew Kanan and Daniel Nocera of the Massachusetts Institute of Technology (MIT) were able to break water apart and force oxygen to bubble to the surface. Protons left behind by the oxygen migrated to a second electrode made of platinum and formed into hydrogen.

Although the process appears simple, it is difficult in practice. Given enough electricity, there are already ways to break water apart. The problem is that the amount of energy required may significantly exceed that which the hydrogen can subsequently be used to generate. Scientists have tried adding chemicals to reduce the amount of electricity needed, but most of the ingredients have been rare and expensive. By using easily obtainable cobalt and phosphates, the MIT work could make it a lot more viable to obtain hydrogen directly from solar cells.

The researchers suggest splitting water into hydrogen and oxygen during the day whenever electricity from solar cells is not needed for anything else. At night the hydrogen could be burned or run through a fuel cell to create power.

The process, reported in *Science*, is similar to how plants work. When they do not need energy immediately, plants transform it into sugar which is stored. When energy is required, the sugar is used—regardless of whether the sun is up or down. Although their experimental work is yet to be commercialised, the MIT researchers suggest that within ten years solar cells using cobalt-based reactions to store energy could help to power some buildings.

Maori and Europeans

Not just killing and cannibalism

Aug 7th 2008
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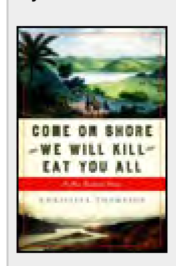
AKG



Early encounters between Maori and Europeans make for a fine historical memoir

THE title of this book is a kind of verbal *haka* or war dance. It is what the Maori were said to have shouted to Captain Cook when he reached New Zealand in 1769. But this offbeat, intimate and absorbing history of Maori and European encounters is not all about killing and cannibalism. There is that, true, and more: gruesome details about tattooing, for example, and head preservation. But it is really a story about mutual incomprehension, illuminated, if not dispelled, by the author's own romance with the Maori, and with one in particular, a man called Seven, whom she married. Against most rational expectations, the marriage has worked. The book is a lesson in the limitations of rational expectation.

Come on Shore and We Will Kill and Eat You All: A New Zealand Story
By Christina Thompson



Bloomsbury; 288 pages; $24.99 and £14.99

Christina Thompson is a New Englander from a trim town outside Boston with a white church and a green. Seven belongs to the Ngapuhi tribe and his family lives in a ramshackle settlement at the end of a dirt road. Ms Thompson is an intellectual in the tradition of the Enlightenment, an editor of the academic *Harvard Review*. Seven, with his belief in ghosts and aliens, is the very man that tradition hopes to enlighten. She weighs options and makes plans. He sees the future not as an arrow he shoots ahead of him, but as an arrow that arrives at his feet.

It all falls neatly into Western categories about "advanced" and "primitive" peoples. But Ms Thompson is not so pat as that. She tells an anecdote about a friend who liked to joke that he was a Bengali trapped in the skin of a European. Her own sensation is not so much of a terrible mistake, but of discovery and arrival; a kind of fatedness. Not that she claims to understand anything. On the contrary, she believes in being willing not to understand, while simultaneously remaining curious and open.

The initial contact especially intrigues her, the bafflement on both sides, an equality of wonder which, however briefly, belies the more common tale of ferocity or exploitation. She describes an evocative episode in 1642, when a Dutch ship is greeted by canoes off New Zealand, and the two sides, after fruitlessly calling to each other in their own languages, resort to music—a series of trumpet calls, first one and then the other, until darkness falls. Sadly there was death in the morning, but as cultural exchanges go, it did not start too badly.

Then there is the story of Charlotte Badger, a convict who was one of the first white women to land in New Zealand, in 1806. She lived among the Maori and twice declined to be “rescued” by ships sailing for England. Ms Thompson recounts the little that is known about her and, drawing on her own experience, imagines, beyond the perils and discomforts, the attraction that must have existed on both sides, in particular the discretion and forbearance of the Maori whom she herself encountered in her husband’s village.

Unlike Charlotte, Ms Thompson does return home, anxiously bringing Seven and, by then, two sons, to her parents’ house. But the expected clash never comes. There are tricky moments—for example, when Seven, an ingenious mechanic, fills the drive with dumped machine parts. But otherwise, he fits into their lives like the natural gentleman she has read about so sceptically in “noble savage” literature. All through the book, the author makes a point of wrong-footing herself. Predicting, interpreting and being clever does not seem to work.

It is Seven’s brother who points to the hidden irony in Ms Thompson’s enterprise. Shortly before leaving for Boston, she tells him that she intends to write his family story. “Write your own first,” he says. It was a shrewd retort. Her ancestors, Englishmen with American-Indian blood on their hands, turn out to be not so different from the people who impoverished Seven’s ancestors. History, in other words, brings her closer to Seven than she could have imagined. It is the charm of this book that the circle never quite closes—that, in its final pages, history itself becomes another foreign country, another adventure.

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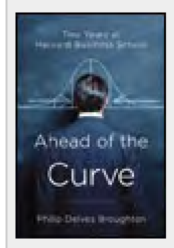
Harvard Business School

Factory for unhappy people

Aug 7th 2008
From The Economist print edition

Get article background

Ahead of the Curve: Two Years at Harvard Business School
By Philip Delves Broughton



Penguin Press; 304 pages; $25.95. Published in Britain as "What They Teach You at Harvard Business School"; Viking; £12.99

Buy it at
Amazon.com
Amazon.co.uk

MORMONS, military and McKinsey are the three Ms said to characterise the student body at Harvard Business School (HBS). Philip Delves Broughton, a British journalist, was none of the above, yet he was prepared to spend $175,000 for a chance to attend this "factory for unhappy people". He never completely fitted in, perhaps because he largely shunned the prodigious alcohol-driven networking for which MBAs are famous, or perhaps because he did not really want to devote his life to getting rich. Yet his engaging memoir suggests he found it a positive experience.

Mr Delves Broughton did not set out to write a book about the course. Nor is this probably the book that HBS would choose to mark its 100th birthday, which it is celebrating extensively this year. Yet anyone considering enrolling will find this an insightful portrait of HBS life, with detailed accounts of case studies and slightly forced classroom fun, such as the students on the back row—the "skydecks"—who rate the performance of their peers. ("HBS had two modes, deadly serious and frat boy.")

For those who know little about contemporary management thinking, as Mr Delves Broughton did when he arrived in 2004, he has put his class notes to good use by providing an excellent layman's guide to the big ideas of the literature. He is a fan of Michael Porter, the nearest thing management theory has to a rock star and, more surprisingly, enjoys a course on co-ordinating and managing supply chains because he "liked the dirt-under-the-fingernails quality of the subject".

Despite this, the author fails to secure a fabulously high-paying job that would give him the private jet which was the "benchmark for being truly rich" while he was at HBS. Yet he had only himself to blame, spending his summer writing a novel when all his classmates were doing the internships that are the essential first step to that dream job.

He graduated healthily "unintimidated by business and its practitioners", not least by HBS itself, which had two failings in his view. First, it pushed the idea that its alumni would be equipped as leaders capable of solving all the world's problems, rather than merely doing a decent job of running a company. "Business needs to relearn its limits, and if the Harvard Business School let some air out of its own balloon, business would listen," he grumbles. His second worry was that so many of his classmates seemed destined for careers that would leave them no space for a happy personal life. He opted for more time with his family, rather than follow in the footsteps of the "Goldman Sachs executive who came to talk about leadership and values…I just remember this look of total defeat on his face when he said how he had four ex-wives."

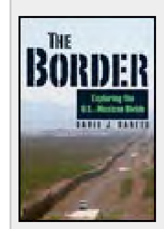
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By Philip Delves Broughton.
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The US-Mexico border

A walk on the wild sides

Aug 7th 2008
From The Economist print edition

The Border: Exploring the US-Mexican Divide
By David J. Danelo



Stackpole Books; 256 pages; $24.95 and £15.50

Buy it at
Amazon.com
Amazon.co.uk

IT IS hard not to like David Danelo, a marine turned journalist and author. In the three months he spends travelling the length of America's southern border, from the Gulf of Mexico in the east to the shores of California in the west, he displays a pleasing concern for almost everyone except politicians and drug pushers.

As a former military man, Mr Danelo understands the hard-pressed officers of the Border Patrol, but he sympathises also with ordinary Mexicans lured to America by the dream of prosperity. To him, illegal immigrants are often nothing more than brave pioneers in search of a better life. He understands too the anguish of Americans who feel swamped by a rising tide of narcotics-fuelled violence. Nothing is easy about immigration, or borders.

What stands out in this personal and readable account is the great variation in attitudes that Mr Danelo encounters as he travels "this 1,952-mile strip of river and earth where the developed world meets the developing; where rich meets poor; where law can mean so much on one side and so little on another." As a native of Austin, though, the author plainly prefers the more tolerant attitude of Texas towards its neighbour to the much more negative views he encounters in the other border states, especially New Mexico.

Texas, Mr Danelo surmises, may be conditioned by having once been part of the Mexican empire—the Alamo and San Jacinto notwithstanding. Texans instinctively understand that a fairly open border has been good for both sides. One of the fastest growing cities in America over the past decade has been McAllen, which sits on the Texas-Mexico border and is a testament to the huge burst of job creation that the North American Free-Trade Agreement has brought to this part of the world.

But the border brings bad things too. Mr Danelo calculates that the drugs business is worth some $60 billion a year to Mexico, but notes that in 2007 George Bush asked Congress for a measly $500m to fight the menace. The Mexican government has repeatedly asked the Americans for more help in tackling the drug lords who have made many of its own border cities violent to the point of being almost ungovernable—but to little effect.

Mr Danelo also has strong views about what will work and what won't. Only better intelligence, which means working much more closely with the Mexicans, will do the job. The biggest possible waste of money, he reckons, is the planned construction of 700 miles of fence along the border. This, he says, is because 80% or more of the drugs that enter America from Mexico do so through perfectly legal checkpoints, disguised among ordinary commercial goods. Drug barons call these entry points *plazas*. Each day 10,000 freight trucks enter America through Laredo alone, the gateway to the mighty I-35 interstate that bisects the country and runs all the way north to the Great Lakes.

Nor, he reckons, will the fence be any good at keeping out illegals; it will be too easy to cross, the thick *carrizo* cane that lines the Rio Grande offering plenty of cover. Besides, building the fence, which has to be done on the American side, means effectively ceding land and the river itself to Mexico. Property-owners hate that idea, and a powerful lobby group against the fence has sprung up in Texas.

A scholarly book this is not, though it brings in entertaining, if patchy, slices of history. If you want a feel for the strange, dangerous and inspiring entity that is both the border and *la frontera*, this is a pretty good place to start.

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By David J. Danelo.
Stackpole Books; 256 pages; $24.95 and £15.50

Americans in the Gulag

Chained ghosts

Aug 7th 2008
From The Economist print edition

The Forsaken: An American Tragedy in Stalin's Russia
By Tim Tzouliadis



Penguin Press; 436 pages; $29.95. Little, Brown; £20

PARANOIA and exhibitionism, two of the defining characteristics of the Soviet system, make a nasty mix. It was the Soviet Union's desire to crow over depression-stricken America that encouraged it to let hundreds of workers, desperate for jobs and a new start in life, immigrate there in the early 1930s. Exactly how many nobody knows; almost all ended up in mass graves. Initially lauded as welcome refugees from the miseries of capitalism (and as useful specialists who might help replicate the bits of it that worked, such as factories) from 1935 onwards they became enemies of the people, infiltrators and spies. A tiny handful, such as Paul Robeson, a singer, were tolerated as propaganda trophies. The rest sank into a living Hades of torture, rape, slave labour, starvation, frostbite and death, shared with millions of others.

The horrors of the Gulag ought to be as well known as Auschwitz, but they aren't. Tim Tzouliadis includes many of them in his sprawling narrative. His statistics are sometimes sloppy and he seems barely aware that for most of its people the Soviet Union was already a hell-hole, even when the American workers were happily playing baseball in Gorky Park.

The real value of his book is in chronicling the extraordinarily supine behaviour of American bureaucrats and politicians towards the fate of their fellow-countrymen. Even before their arrest, most of the Americans were, in effect, prisoners: with their passports confiscated they were involuntary Soviet citizens. But the only people who might have helped saw no reason to do so. Diplomats in America's newly established embassy in Moscow regarded all the migrants as communist sympathisers who had thrown in their lot with the system. Some were, but many were not. Yet the diplomats put every obstacle and delay in the way of desperate people who were risking instant arrest for even contacting the embassy, for example by demanding that fees for replacement passports be paid in dollars at a time when possession of hard currency was a criminal offence.

Equally astonishing was the lack of even a single squeak of protest. America's ambassador, Joseph Davies, was an idle, gullible, Stalin-loving art collector. When the case of a missing American was half-heartedly raised by a subordinate, he promptly apologised to the Russians. Even when Americans working as locally hired staff at the embassy were arrested, nobody complained. George Kennan, a diplomat, eventually realised what was happening and wrote an eloquent memo. But nobody acted.

If the diplomats look bad, so too do the Moscow-based foreign journalists, who shunned the story as liable to risk their official accreditation; the debaucheries on offer nightly at the Hotel Metropol, courtesy of the NKVD secret police, may have led them to choose their own livelihoods over the lives of others.

The outbreak of war would have been a chance to ask for Stalin's co-operation. Allied pressure brought a ragtag army of starving Poles from the depths of Siberia. But nobody cared about the Americans. President Franklin Roosevelt and his advisers emerge remarkably badly on this issue, seemingly determined not to bother Stalin with such trifles.

The most revolting and murky twist to the story is the treatment of another wave of American captives: prisoners-of-war in Germany who had the misfortune to be freed by Soviet troops and were deported to the Gulag. Clues abounded, chiefly from defectors and former Gulag inmates who reached the West. Yet the files remained secret. Neither their fate, nor that of Americans captured during the Korean War, received attention. The American Red Cross brushed aside a request to intervene, saying that inquiries about Americans "domiciled" (hardly the right word) in NKVD camps would be a source of "annoyance, if not embarrassment".

A handful of survivors returned to tell their story to an often disbelieving public. Mr Tzouliadis has unearthed scandalous nuggets from the American archives. In that sense, he is right in his comforting assertion that “the truth, although it may be initially disbelieved, will always surface eventually.” But in another sense he is wrong. Even if the Russian archives were to yield everything they contain about the American names that so tantalisingly surface in his book, other questions would remain unanswered. When the eyewitnesses, perpetrators and victims are all dead, the real story of a crime dies too.

The Forsaken: An American Tragedy in Stalin’s Russia.
By Tim Tzouliadis.
Penguin Press; 436 pages; $29.95. Little, Brown; £20

Laura Beatty's “Pollard”

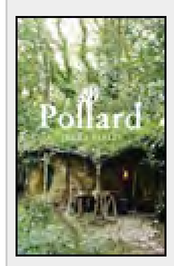
Into the woods

Aug 7th 2008
From The Economist print edition

IN “A Midsummer Night’s Dream”, Demetrius describes himself as “wood within this wood”. The Elizabethans associated madness with forests, but in Laura Beatty’s first novel, “Pollard”, an unhinged mind finds lucidity in the woods.

Illustration by Daniel Pudles

Pollard
By Laura Beatty



Chatto & Windus; 320 pages; £16.99

Buy it at
Amazon.co.uk

Anne, a 15-year-old who “can’t see the wood for the trees”, abandons her awful family and moves to the forest where she clears a copse, dams a stream and builds herself a shelter. In this environment, whose slow development matches her own, Anne gains a self-assurance skilfully reflected by the growing confidence of Ms Beatty’s prose. She snares rabbits, milks cows, eats birds’ eggs, and establishes a particular connection with a visiting fox who is both her competitor and, as a clever woodland survivor, the object of Anne’s grudging admiration.

This is not, however, an unpeopled wilderness; the wattle-and-daub walls of Anne’s hut are strung with lost dummies, and joggers occasionally crash bemused into her clearing. Some of these human incursions penetrate Anne’s world more significantly. She falls in love with “Slow Steve”, their relationship described with an almost painful emotional subtlety by a narrator who lacks the ability to define her emotions even to herself. Later Anne meets “Ranger”, a quasi-feudal figure, and “Peter Parker”, a troubled boy for whom Anne develops a deep affection despite his destructive tendencies. The prose becomes progressively elegiac, reverberating with the buzzing of chainsaws. The deer vanish and even the fox is killed in a scene devastating both in itself and as a portent of what is to come.

This is a moving novel, delicate yet powerful, whose unusual heroine charms absolutely. “The distillation of a particular life, lived against the grain of time”, its significance expands like the rings of a tree-trunk. Anne, like a Swiss Family Robinson child picking up Pepsi cans, feels like an anachronism, and yet the environmental message is highly relevant. The lesson, ultimately, is one of survival. In the epilogue, Ms Beatty claims that “survival doesn’t come naturally to us any more”. At the same time one cannot help wondering how long survival will come “naturally” to the wildernesses on which human survival depends.

Pollard.
By Laura Beatty.
Chatto & Windus; 320 pages; £16.99

Summer cinema

Eyeing the storm

Aug 7th 2008
From The Economist print edition

A rumble in the jungle

BEN STILLER is an actor best taken in moderate doses, and no one knows that better than Mr Stiller himself. Surrounded by a superb group of actors playing actors in his fifth directorial effort, “Tropic Thunder”, he leads them to stratospheric heights of silliness, yet in the end never falters.

Tugg Speedman (Mr Stiller) is a failing action star who badly needs a hit after the humiliating failure of his previous attempt to reignite his career, a film called “Simple Jack” about a mentally impaired farmhand who talks to animals. Speedman chooses as inspiration the Vietnam memoirs of a courageous war hero, John “Four Leaf” Tayback (Nick Nolte), and begins to assemble a cast of actors.

There is Jeff “Fats” Portnoy (Jack Black), whose gonzo comedies have made him the emperor of flatulence; Kirk Lazarus (Robert Downey Jr) a five-time Oscar winner who is so far into the character of an African-American sergeant, Lincoln Osiris, that he can no longer get out of it; and Alpa Chino (Brandon T. Jackson), a rapper who finds Kirk’s unshakable black persona offensively racist. As the film limps through its ill-starred first week of production in the jungle, each character is looking for redemption, except for Kevin Sandusky (Jay Baruchel), a bespectacled newcomer who is happy just to have a job.

In short order, the unseasoned British director of the film-within-the-film decides to leave the group in the jungle, abandoning the script, and film them instead with hidden cameras. Very quickly the gang finds itself at the mercy of a ferocious band of local drug-traffickers who suspect the actors are working for the Drug Enforcement Administration.

It is just as well this all happens fast. There are some dry patches while Mr Stiller elaborates his premise, but he is really setting up his characters, who become very funny in the second half. Speedman’s colleagues have to rescue him from torture at the hands of a 12-year-old drug lord (Brandon Soo Hoo), whose favourite film, it turns out, is “Simple Jack”.

Foolish though it might be, in the end “Tropic Thunder” is about Mr Stiller’s love of actors, and it communicates so much affection for that maligned profession that you want to stand up during the final credits and clap.

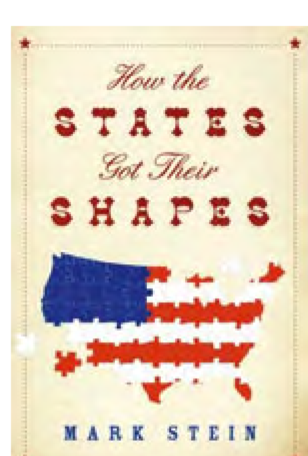
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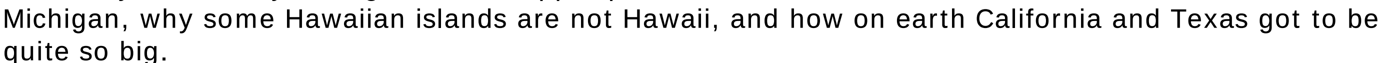
Aug 7th 2008
From The Economist print edition

The world's bestselling travel book visits America's 50 states



WHY does Oklahoma have that panhandle? Why are so many states in the Midwest all square (more or less) and all the same size (also more or less)? Did someone make a mistake? Or did they do it on purpose?

The map of the America's 50 states is so familiar you might be forgiven for thinking their borders had been carved upon the land by Divine Providence. In "How the States Got Their Shapes", the world's biggest-selling travel book, Mark Stein, a screenwriter for "Housesitter", digs up all the detail you never knew about how the state lines were drawn.

Along the way, he highlights a whole array of geographical and historical topics, including: the importance of the 49th parallel, how Idaho's boundary was derailed in 1864 with $2,000 in gold, why West Virginia has a finger creeping up the side of Pennsylvania, why Michigan has an upper peninsula that is not attached to

Michigan, why some Hawaiian islands are not Hawaii, and how on earth California and Texas got to be quite so big.

Top voyager's volumes

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Correction: Food in rich countries

Aug 7th 2008
From The Economist print edition

In our review of Paul Roberts's book, “The End of Food”, we stated that every year obesity causes 400,000 premature deaths in America. Mr Roberts has asked us to point out that this figure relates to 2002. The US Centres for Disease Control and Prevention has since lowered its original estimate to 112,000. Our apologies.

Alexander Solzhenitsyn

Aug 7th 2008
From The Economist print edition

AFP



Alexander Solzhenitsyn, Russian author and dissident, died on August 3rd, aged 89

PEOPLE knew it was there: the vast amazing country of *Gulag* which, “though scattered in an Archipelago geographically, was, in the psychological sense, fused into a continent—an almost invisible, almost imperceptible country.” Trains went in, and people were sent to administer it from the Ministry of Internal Affairs. But until Alexander Solzhenitsyn had spent eight years there, laying bricks and smelting metal in the intensest heat and cold, hearing fellow-inmates, like rats, stealing his food in the dark, wearing wrist-crushing handcuffs for the least infraction, this land was not fully revealed to the outside world. “The Gulag Archipelago” was a book carried out of the camps “on the skin of my back”, to bear witness on behalf of everyone still inside.

Its appearance, in 1973, immediately led to his expulsion from the Soviet Union. But his work was done. He had exposed the fissures in the system, a truth-telling that had begun, 11 years earlier during the Khrushchev thaw, with the publication in *Novy Mir* of “One Day in the Life of Ivan Denisovich”. That tale began with the cacophony of reveille for the prisoners, “sounded by the blows of a hammer on a length of rail” through windows coated in frost two fingers thick. With that banging, even through their imperviousness, the Russian people began to stir to the evils of the cult of personality under which they had lived for too long; after this, though with desperate slowness, the disintegration of the Soviet state was only a matter of time.

He was not another Tolstoy or Dostoevsky. Often the characters in Mr Solzhenitsyn’s books were one-dimensional, the tone sardonic, the detail turgid. But his indestructibility gave him, over the years, a prophet’s voice. He survived the war, the camps and abdominal cancer that was carelessly treated. He was told he would never have children, but had three sons. He believed he would never return to Russia after his exile, but in 1994 was welcomed back to the post-Soviet state. Each miracle increased his sense of mission. He was not simply a writer, but a visionary who would mend Russia; and, as such, he believed he was on equal terms with Soviet leaders. In 1973, in a letter to them, he laid out his proposals. There was nothing wrong with a Soviet empire; but they had to cast off “this filthy sweaty shirt” of Marxist ideology, all these “arsenals of lies”. Socialism, he wrote, “prevents the living body of the nation from breathing.”

Behind his impassive kulak’s face lay intense self-scrutiny, adamantine moral and physical courage and a sometimes unsettling disregard for the smaller and softer things in life. But he did not necessarily think he was better, or wiser, than other men. Only a fluke, he said, had kept him out of the NKVD, Stalin’s

secret police, when they came recruiting at his university. As for the war, though the Nazis had unleashed atrocities on Russia, "I remember myself in my captain's shoulder-straps and the forward march of my battery through East Prussia, enshrouded in fire, and I say: 'So were we any better?'" In one poem, "Prussian Nights", he wrote:

> The little daughter's on the mattress,
> Dead. How many have been on it
> A platoon, a company perhaps?
> A girl's been turned into a woman,
> A woman turned into a corpse

Salvo after salvo rattled from the Solzhenitsyn typewriter, always interleaved with carbon copies for fear that the secret police would seize the manuscript. Some fell on deaf ears—wilfully deaf, in the case of the European left. The notion that Stalin was a great wartime leader, for example, should never have survived the devastating portrait of sickly paranoia in "The First Circle" (1969). Yet it has persisted to this day.

Though supporters in the West lumped Mr Solzhenitsyn with the rest of the intelligentsia, he stood monumentally alone. A friendship with an Estonian prisoner, Arnold Susi, had exploded his lingering belief in Marxism; but he detested the self-regarding and snooty Russian intellectuals, the "well-read ones", as he referred to them. Unlike Andrei Sakharov, he had no belief in liberalism or human-rights campaigns. The fact that scientists might be deprived of visas left him unmoved. He cared about the fate of peasants and the general citizenry, Russians in the mass. Ivan Denisovich was not an intellectual: he was a peasant who was horrified to discover, in a letter from his wife, that the farmers in his village were now working in factories rather than haymaking. The creation of Soviet man was the horror Mr Solzhenitsyn chiefly wished to reverse.

Neither East nor West

Yet he had little time for the West either. Bundled on to a plane to West Germany in 1974, he turned his fire on other targets, thundering against materialism, shallowness and the silliness of popular Western culture. He would be no cold-war figurehead against the Kremlin and all its works; he was, to the core, a Russian nationalist. As communism fell he came to loathe Boris Yeltsin, Russia's leader, seeing him as the author of chaos and humiliation. But bitterness and envy may have played a part, too. Bitterness because his hero's welcome had turned into indifference to this dishevelled, hectoring, old-fashioned figure. And envy because Yeltsin stood in the place he should, he believed, have occupied himself.

Overview

Aug 7th 2008
From The Economist print edition

The Federal Reserve left its benchmark interest rate unchanged, at 2%. The Fed's statement suggested its concerns about **America's** GDP growth and inflation were broadly balanced. Employers, excluding farms, cut payrolls by 51,000 in July. The unemployment rate rose from 5.5% to 5.7%.

There was fresh evidence that the **euro area's** economy is struggling. Retail sales fell by 0.6% in June, leaving them 3.1% lower than in June 2007. Sales in **Spain** were particularly weak, down 7.7% from a year earlier. Factory orders in **Germany** fell for a seventh consecutive month in June.

Industrial production in **Britain** fell by 0.2% in June, leaving it 1.6% lower than it had been a year earlier.

The Bank of Korea raised its benchmark interest rate by a quarter of a percentage point, to an eight-year high of 5.25%. **South Korea's** central bank considers inflation a bigger worry than a weakening economy. **Indonesia's** central bank also raised rates by a quarter-point, to 9%.

The Reserve Bank of **Australia** kept its benchmark interest rate at 7.25%. It hinted that it might cut rates soon.

Forecasts for GDP growth in 2008 were lowered for eight of the 14 economies featured in *The Economist's* monthly **poll of forecasters**. America was an exception. Its GDP growth forecast was revised up slightly, from 1.4% to 1.5%.



Output, prices and jobs

Aug 7th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+1.8 Q2	+1.9	+1.5	+1.2	+0.3 Jun	+5.0 Jun	+2.7	+4.4	5.7 Jul
Japan	+1.3 Q1	+4.0	+1.4	+1.2	+0.2 Jun	+2.0 Jun	-0.2	+1.6	4.1 Jun
China	+10.1 Q2	na	+9.8	+9.0	+16.0 Jun	+7.1 Jun	+4.4	+6.6	9.5 2007
Britain	+1.6 Q2	+0.8	+1.4	+1.0	-1.6 Jun	+3.8 Jun§	+2.4	+3.6	5.2 May††
Canada	+1.7 Q1	-0.3	+1.2	+1.9	-4.6 May	+3.1 Jun	+2.2	+2.3	6.2 Jun
Euro area	+2.1 Q1	+2.8	+1.6	+1.2	-1.9 May	+4.1 Jul	+1.8	+3.6	7.3 Jun
Austria	+2.8 Q1	+2.8	+2.3	+1.7	+5.4 May	+3.9 Jun	+2.0	+2.9	4.1 Jun
Belgium	+2.0 Q2	+1.2	+1.6	+1.3	+1.5 May	+5.9 Jul	+1.4	+4.4	10.0 Jun‡‡
France	+2.0 Q1	+1.8	+1.5	+1.2	-1.2 May	+3.6 Jun	+1.2	+3.3	7.5 Jun
Germany	+2.6 Q1	+6.3	+2.0	+1.3	+0.8 May	+3.3 Jul	+2.1	+3.0	7.8 Jul
Greece	+3.6 Q1	+4.5	+2.8	+2.8	-6.6 May	+4.9 Jun	+2.6	+4.6	7.7 Apr
Italy	+0.3 Q1	+1.9	+0.4	+0.7	-1.8 Jun	+4.1 Jul	+1.6	+3.6	6.5 Q1
Netherlands	+3.3 Q1	+1.8	+2.4	+1.6	+0.6 May	+3.2 Jul	+1.5	+2.5	4.0 Jun††
Spain	+2.7 Q1	+1.1	+1.6	+1.0	-9.0 Jun	+5.0 Jun	+2.4	+4.3	10.7 Jun
Czech Republic	+5.3 Q1	+3.6	+4.7	+5.4	+3.4 May	+6.7 Jun	+2.5	+6.6	5.0 Jun
Denmark	-0.7 Q1	-2.4	+1.0	+1.0	+7.2 May	+3.8 Jun	+1.4	+3.4	1.6 Jun
Hungary	+1.7 Q1	+1.3	+0.9	+4.7	-0.3 Jun	+6.7 Jun	+8.6	+6.5	7.6 Jun††
Norway	+0.9 Q1	+0.8	+2.5	+2.2	+5.9 Jun	+3.4 Jun	+0.4	+3.3	2.5 May***
Poland	+6.1 Q1	na	+5.4	+4.3	+7.2 Jun	+4.6 Jun	+2.6	+4.2	9.6 Jun‡‡
Russia	+8.5 Q1	na	+7.5	+6.8	+0.9 Jun	+16.2 Jun	+8.4	+13.9	6.2 Jun‡‡
Sweden	+0.7 Q2	-0.1	+1.9	+1.7	-5.0 May	+4.4 Jul	+1.9	+3.7	8.1 Jun‡‡
Switzerland	+3.1 Q1	+1.3	+2.0	+1.4	+4.4 Q1	+3.1 Jul	+0.7	+2.7	2.6 Jun
Turkey	+6.6 Q1	na	+4.5	+4.3	+2.4 May	+12.1 Jul	+6.9	+11.0	10.7 Q1‡‡
Australia	+3.6 Q1	+2.5	+2.8	+2.7	+2.4 Q1	+4.5 Q2	+2.1	+4.0	4.3 Jul
Hong Kong	+6.8 Q1	+7.4	+4.7	+4.4	-4.4 Q1	+6.1 Jun	+1.4	+5.3	3.3 Jun††
India	+8.8 Q1	na	+7.7	+7.1	+3.8 May	+7.7 Jun	+5.7	+7.1	7.2 2007
Indonesia	+6.3 Q1	na	+5.9	+5.7	+4.4 May	+11.9 Jul	+5.3	+9.9	8.5 Feb
Malaysia	+7.1 Q1	na	+6.0	+5.8	+2.6 May	+7.7 Jun	+1.4	+5.4	3.6 Q1
Pakistan	+5.8 2008**	na	+3.6	+4.4	+2.7 May	+21.5 Jun	+7.0	+17.6	5.6 2007
Singapore	+1.9 Q2	-6.6	+4.8	+4.9	+2.5 Jun	+7.5 Jun	+1.3	+6.0	2.3 Q2
South Korea	+4.8 Q2	+3.4	+4.4	+4.2	+6.7 Jun	+5.9 Jul	+2.5	+4.2	3.2 Jun
Taiwan	+6.1 Q1	na	+4.3	+4.4	+5.1 Jun	+5.9 Jul	-0.3	+3.4	3.9 Jun
Thailand	+6.0 Q1	+5.9	+4.8	+4.5	+11.2 Jun	+9.2 Jul	+1.7	+8.5	1.5 Apr
Argentina	+8.4 Q1	+2.4	+6.0	+4.0	+6.1 Jun	+9.3 Jun	+8.8	+9.7	8.4 Q1‡‡
Brazil	+5.8 Q1	+2.9	+4.6	+3.4	+6.6 Jun	+6.1 Jun	+3.7	+6.1	7.8 Jun‡‡
Chile	+3.0 Q1	+5.8	+3.6	+3.8	-0.9 Jun	+9.5 Jun	+3.2	+7.5	8.4 Jun††‡‡
Colombia	+4.1 Q1	-3.7	+4.5	+4.0	-4.3 May	+7.5 Jul	+5.8	+6.7	10.7 May‡‡
Mexico	+2.6 Q1	+2.1	+2.3	+2.5	-1.2 May	+5.3 Jun	+4.0	+4.8	3.6 Jun‡‡
Venezuela	+4.8 Q1	na	+5.2	+3.0	+19.9 Apr	+32.2 Jun	+19.4	+30.6	8.5 Q1‡‡
Egypt	+6.9 Q1	na	+7.1	+6.7	+7.5 2007**	+20.2 Jun	+8.5	+17.1	9.0 Q1‡‡
Israel	+5.2 Q1	+5.4	+3.9	+3.6	+7.2 May	+4.8 Jun	-0.7	+4.2	6.3 Q1
Saudi Arabia	+3.5 2007	na	+7.2	+6.7	na	+10.6 Jun	+3.4	+8.5	na
South Africa	+4.0 Q1	+2.1	+3.9	+4.4	+0.7 May	+12.2 Jun	+7.0	+9.6	23.0 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+0.1 Q1	+7.8	-0.6	+2.0	-4.7 Jun	+11.1 Jul	+6.4	+10.5	4.1 May
Finland	+3.1 Q1	+2.7	+2.8	+2.4	-3.3 Jun	+4.4 Jun	+2.5	+3.8	6.3 Jun
Iceland	+1.1 Q1	-14.0	nil	+0.8	+0.4 2007	+13.6 Jul	+3.8	+12.0	1.1 Jun‡‡
Ireland	-1.5 Q1	-0.9	-1.3	-0.4	+9.2 May	+5.0 Jun	+4.9	+3.6	5.9 Jul
Latvia	+3.3 Q1	na	+2.4	+2.6	-6.4 Jun	+17.7 Jun	+8.8	+15.0	5.6 May
Lithuania	+5.5 Q2	+4.5	+5.5	+4.8	na	+12.5 Jun	+4.8	+11.0	4.7 Jun‡‡
Luxembourg	+2.5 Q1	+5.3	+3.0	+2.6	+6.4 May	+4.3 Jun	+2.0	+3.9	4.0 Jun‡‡
New Zealand	+0.9 Q1	-2.3	+0.7	+1.6	+2.4 Q1	+4.0 Q2	+2.0	+4.1	3.6 Q1
Peru	+7.3 May	na	+7.9	+6.6	+4.6 May	+5.8 Jul	+2.2	+5.3	7.4 Jun††
Philippines	+5.1 Q1	+3.0	+4.8	+5.7	+5.2 Apr	+12.2 Jul	+2.6	+8.3	8.0 April‡‡
Portugal	+0.9 Q1	-1.0	+1.4	+1.3	-4.2 Jun	+3.4 Jun	+2.4	+2.7	7.6 Q1‡‡
Slovakia	+8.7 Q1	na	+7.5	+5.2	+4.0 May	+4.6 Jun	+2.5	+4.2	7.4 Jun‡‡
Slovenia	+5.4 Q1	na	+4.5	+4.0	-0.8 May	+6.9 Jul	+3.8	+6.0	6.5 May‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 4.6% in June. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted.§§New series ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Aug 7th 2008
From The Economist print edition

The Economist commodity-price index
2000=100

	Jul 29th	Aug 5th*	% change on one month	% change on one year
Dollar index				
All items	250.9	241.2	-9.2	+18.1
Food	252.8	242.6	-10.2	+38.9
Industrials				
All	248.5	239.2	-7.8	-1.4
Nfa†	200.2	195.5	-4.0	+19.5
Metals	275.0	263.2	-9.2	-7.9
Sterling index				
All items	192.1	187.0	-8.4	+22.1
Euro index				
All items	148.8	144.0	-8.1	+4.9
Gold				
$ per oz	918.20	880.40	-3.8	+31.3
West Texas Intermediate				
$ per barrel	122.20	118.73	-12.6	+64.2

*Provisional †Non-food agriculturals.

The Economist poll of forecasters, August averages

Aug 7th 2008
From The Economist print edition

The Economist **poll of forecasters, August averages** (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2008	2009	2008	2009	2008	2009	2008	2009
Australia	2.5/3.4	2.4/2.9	2.8 (2.9)	2.7 (2.8)	4.0 (3.7)	3.2 (3.0)	−5.6 (−5.5)	−4.9 (−5.0)
Belgium	1.5/2.0	0.8/1.9	1.6 (1.7)	1.3 (1.5)	4.4 (3.9)	2.6 (2.5)	1.1 (1.6)	1.0 (1.6)
Britain	1.2/1.7	0.3/1.4	1.4 (1.6)	1.0 (1.2)	3.6 (3.4)	2.9 (2.6)	−3.6 (−4.1)	−3.5 (−3.8)
Canada	0.4/1.8	nil/2.5	1.2 (1.3)	1.9 (2.0)	2.3 (2.0)	2.3 (2.1)	0.8	0.7 (0.6)
France	1.3/1.7	0.7/1.8	1.5 (1.7)	1.2 (1.3)	3.3 (3.2)	2.3 (2.2)	−1.5 (−1.6)	−1.6
Germany	1.6/2.3	0.6/2.2	2.0	1.3 (1.5)	3.0 (2.9)	2.3 (2.2)	6.4 (6.3)	5.8 (5.7)
Italy	0.1/0.6	0.3/0.9	0.4	0.7 (0.8)	3.6 (3.4)	2.6 (2.5)	−2.7 (−2.6)	−2.7 (−2.5)
Japan	0.9/2.0	0.6/1.6	1.4	1.2 (1.3)	1.6 (1.4)	1.0 (0.9)	4.1	4.2
Netherlands	2.0/2.7	1.2/2.3	2.4	1.6 (1.7)	2.5 (2.4)	2.5 (2.4)	5.9 (6.0)	5.5 (6.0)
Spain	0.9/2.2	0.1/1.9	1.6 (1.7)	1.0 (1.2)	4.3 (4.2)	3.0 (2.9)	−9.4 (−9.5)	−8.6 (−8.5)
Sweden	1.2/2.4	1.3/2.3	1.9 (2.1)	1.7 (2.0)	3.7 (3.3)	2.8 (2.5)	7.9 (8.1)	7.3 (7.6)
Switzerland	1.6/2.2	1.0/1.9	2.0	1.4 (1.5)	2.7 (2.4)	1.9 (1.7)	13.9 (15.1)	13.2 (14.5)
United States	0.8/2.1	0.7/2.1	1.5 (1.4)	1.2 (1.3)	4.4 (4.2)	2.7	−4.8 (−4.9)	−4.4 (−4.5)
Euro area	1.3/1.9	0.7/1.7	1.6 (1.7)	1.2 (1.3)	3.6 (3.5)	2.6 (2.4)	−0.3	−0.3

Sources: ABN AMRO, BNP Paribas, Citigroup, Decision Economics, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, JPMorgan Chase, Morgan Stanley, Scotiabank, UBS



Trade, exchange rates, budget balances and interest rates

Aug 7th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Aug 6th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	-835.2 May	-710.7 Q1	-4.8	-	-	-2.4	2.14	4.05
Japan	+101.0 May	+215.1 May	+4.1	109	120	-2.7	0.75	1.52
China	+248.7 Jun	+371.8 2007	+8.6	6.85	7.57	0.5	4.33	4.87
Britain	-185.4 May	-102.4 Q1	-3.6	0.51	0.49	-3.8	5.76	4.74
Canada	+45.7 May	+14.5 Q1	+0.8	1.05	1.05	0.2	2.48	3.70
Euro area	+12.9 May	-14.2 May	-0.3	0.65	0.72	-0.9	4.97	4.33
Austria	+0.3 May	+14.8 Q1	+2.9	0.65	0.72	-0.6	4.97	4.49
Belgium	+11.6 Apr	-1.1 Mar	+1.1	0.65	0.72	-0.7	5.04	4.67
France	-70.2 Jun	-41.6 May	-1.5	0.65	0.72	-2.9	4.97	4.50
Germany	+286.2 Jun	+273.6 Jun	+6.4	0.65	0.72	1.2	4.97	4.32
Greece	-61.8 Apr	-48.7 May	-13.9	0.65	0.72	-2.6	4.97	4.95
Italy	-11.8 May	-63.5 May	-2.7	0.65	0.72	-2.6	4.97	4.89
Netherlands	+60.4 May	+50.7 Q1	+5.9	0.65	0.72	0.7	4.97	4.49
Spain	-151.1 May	-163.9 May	-9.4	0.65	0.72	-1.1	4.97	4.64
Czech Republic	+5.5 Jun	-3.6 May	-2.7	15.5	20.4	-1.8	3.89	4.40
Denmark	+4.8 May	+3.5 May	+1.0	4.84	5.39	3.8	5.70	4.60
Hungary	+0.5 May	-7.2 Q1	-3.6	153	180	-4.3	8.55	7.94
Norway	+73.9 Jun	+68.8 Q1	+17.3	5.21	5.76	17.7	6.44	4.79
Poland	-17.8 May	-20.9 May	-4.9	2.10	2.73	-1.9	6.55	6.16
Russia	+164.1 May	+109.8 Q2	+6.0	23.6	25.4	3.6	11.00	6.78
Sweden	+18.3 Jun	+40.4 Q1	+7.9	6.10	6.69	2.4	4.25	4.18
Switzerland	+15.5 Jun	+91.4 Q1	+13.9	1.06	1.19	0.9	2.75	3.02
Turkey	-72.1 Jun	-43.0 May	-6.4	1.16	1.26	-2.7	18.11	6.84‡
Australia	-18.4 Jun	-61.4 Q1	-5.6	1.10	1.16	1.4	7.35	6.04
Hong Kong	-25.6 Jul	+26.6 Q1	+9.0	7.80	7.83	3.0	2.67	3.40
India	-87.5 Jun	-17.5 Q1	-3.0	42.1	40.5	-3.4	9.33	9.53
Indonesia	+37.5 Jun	+10.9 Q1	+2.7	9,073	9,295	-1.9	9.87	7.28‡
Malaysia	+37.6 Jun	+30.6 Q1	+13.9	3.28	3.46	-3.1	3.70	4.54‡
Pakistan	-20.7 Jun	-10.5 Q1	-8.6	72.5	60.4	-6.7	13.17	12.11‡
Singapore	+28.5 Jun	+35.8 Q1	+19.4	1.38	1.51	1.0	1.00	2.86
South Korea	-1.6 Jul	+2.2 Jun	-2.5	1,016	924	1.5	5.71	5.72
Taiwan	+13.9 Jul	+32.2 Q1	+5.2	30.8	32.9	-1.8	2.75	2.50
Thailand	+7.8 Jun	+12.7 Jun	-0.4	33.6	34.0	-3.0	3.80	4.76
Argentina	+10.8 Jun	+7.9 Q1	+2.9	3.04	3.13	1.7	13.81	na
Brazil	+30.8 Jul	-18.1 Jun	-1.3	1.58	1.88	-1.6	12.92	6.16‡
Chile	+18.9 Jun	+4.3 Q1	+0.5	512	518	8.9	6.96	4.36‡
Colombia	+0.6 May	-5.0 Q1	-2.6	1,786	1,974	-1.0	9.73	5.95‡
Mexico	-7.8 Jun	-4.8 Q1	-0.8	9.96	10.9	-0.1	8.11	8.78
Venezuela	+30.1 Q1	+26.7 Q1	+12.1	3.30	4.23§	1.6	17.18	6.55‡
Egypt	-22.2 Q1	-0.1 Q1	+0.2	5.31	5.64	-7.1	10.88	5.39‡
Israel	-13.4 Jun	+4.4 Q1	+0.2	3.55	4.26	-1.3	3.96	5.24
Saudi Arabia	+150.8 2007	+95.0 2007	+36.9	3.75	3.75	22.3	3.91	na
South Africa	-10.3 Jun	-22.3 Q1	-8.0	7.45	7.03	0.4	12.30	9.29
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	-4.2 May	-3.3 May	-10.5	10.1	11.3	-0.4	6.35	na
Finland	+12.2 May	+9.6 May	+4.5	0.65	0.72	4.5	4.90	4.49
Iceland	-1.1 Jun	-3.5 Q1	-14.6	79.4	63.1	2.0	15.97	na
Ireland	+38.4 May	-14.7 Q1	-5.2	0.65	0.72	-4.1	4.97	4.66
Latvia	-6.7 May	-6.0 May	-15.5	0.46	0.50	nil	5.87	na
Lithuania	-7.8 May	-6.0 May	-14.0	2.24	2.50	-0.7	5.76	na
Luxembourg	-6.6 May	+4.9 Q1	na	0.65	0.72	0.5	4.97	na
New Zealand	-3.4 Jun	-10.4 Q1	-7.1	1.39	1.30	1.2	7.65	6.17
Peru	+7.8 May	+0.8 Q1	-1.1	2.80	3.15	2.3	5.90	na
Philippines	-8.0 May	+5.6 Mar	+2.6	43.8	45.2	-0.9	5.13	na
Portugal	-30.3 Apr	-26.7 May	-9.0	0.65	0.72	-2.5	4.97	4.76
Slovakia	-0.9 May	-5.0 Apr	-4.2	19.7	24.1	-2.1	3.49	4.96
Slovenia	-3.6 May	-2.9 May	-5.8	0.65	0.72	0.1	na	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.



Markets

Aug 7th 2008
From The Economist print edition

Markets

		% change on		
			Dec 31st 2007	
	Index Aug 6th	one week	in local currency	in $ terms
United States (DJIA)	11,656.1	+0.6	−12.1	−12.1
United States (S&P 500)	1,289.2	+0.4	−12.2	−12.2
United States (NAScomp)	2,378.4	+2.1	−10.3	−10.3
Japan (Nikkei 225)	13,254.9	−0.8	−13.4	−11.4
Japan (Topix)	1,277.3	−2.0	−13.4	−11.4
China (SSEA)	2,853.0	−4.1	−48.3	−44.9
China (SSEB, $ terms)	199.7	−6.0	−48.8	−45.4
Britain (FTSE 100)	5,486.1	+1.2	−15.0	−16.7
Canada (S&P TSX)	13,453.5	−1.7	−2.7	−8.2
Euro area (FTSE Euro 100)	1,058.5	+1.1	−23.0	−18.8
Euro area (DJ STOXX 50)	3,409.0	+1.2	−22.5	−18.3
Austria (ATX)	3,666.0	+0.7	−18.8	−14.3
Belgium (Bel 20)	3,124.0	+3.1	−24.3	−20.2
France (CAC 40)	4,448.3	+1.1	−20.8	−16.4
Germany (DAX)*	6,561.4	+1.6	−18.7	−14.2
Greece (Athex Comp)	3,438.8	+1.2	−33.6	−30.0
Italy (S&P/MIB)	29,014.0	+2.1	−24.7	−20.6
Netherlands (AEX)	410.5	+1.5	−20.4	−16.1
Spain (Madrid SE)	1,267.9	−0.3	−22.8	−18.6
Czech Republic (PX)	1,459.6	−1.0	−19.6	−5.9
Denmark (OMXCB)	390.6	+1.7	−13.0	−8.3
Hungary (BUX)	21,506.0	−4.5	−18.0	−7.2
Norway (OSEAX)	472.0	−2.9	−17.2	−13.8
Poland (WIG)	41,437.1	−2.3	−25.5	−12.8
Russia (RTS, $ terms)	1,814.6	−6.9	−23.7	−20.8
Sweden (Aff.Gen)	274.3	+2.5	−19.4	−14.7
Switzerland (SMI)	7,209.3	+1.4	−15.0	−9.1
Turkey (ISE)	42,075.9	+1.8	−24.2	−23.8
Australia (All Ord.)	5,018.1	+0.2	−21.8	−18.9
Hong Kong (Hang Seng)	21,949.8	−3.3	−21.1	−21.2
India (BSE)	15,073.5	+5.5	−25.7	−30.4
Indonesia (JSX)	2,187.2	−4.0	−20.3	−17.5
Malaysia (KLSE)	1,133.6	−2.3	−21.6	−20.8
Pakistan (KSE)	9,678.8	−10.8	−31.2	−41.5
Singapore (STI)	2,886.8	−1.3	−16.7	−13.3
South Korea (KOSPI)	1,578.7	+0.1	−16.8	−23.3
Taiwan (TWI)	7,026.2	−0.6	−17.4	−12.9
Thailand (SET)	676.4	+1.0	−21.2	−21.0
Argentina (MERV)	1,871.7	−4.0	−13.0	−10.0
Brazil (BVSP)	57,542.0	−4.1	−9.9	+1.4
Chile (IGPA)	14,205.0	−0.8	+0.9	−1.9
Colombia (IGBC)	8,888.9	−0.6	−16.9	−6.1
Mexico (IPC)	27,342.4	−0.5	−7.4	+1.4
Venezuela (IBC)	39,720.8	+0.2	+4.8	−31.8
Egypt (Case 30)	8,922.7	−2.3	−14.8	−11.4
Israel (TA-100)	929.6	−1.8	−19.5	−12.6
Saudi Arabia (Tadawul)	8,451.1	−3.3	−23.4	−23.4
South Africa (JSE AS)	26,945.4	−3.0	−7.0	−14.6
Europe (FTSEurofirst 300)	1,193.0	+1.0	−20.8	−16.5
World, dev'd (MSCI)	1,369.2	−0.4	−13.8	−13.8
Emerging markets (MSCI)	1,012.2	−2.6	−18.7	−18.7
World, all (MSCI)	345.2	−0.7	−14.4	−14.4
World bonds (Citigroup)	762.9	−0.4	+4.5	+4.5
EMBI+ (JPMorgan)	437.7	+0.3	+0.9	+0.9
Hedge funds (HFRX)	1,268.0	−0.8	−4.6	−4.6
Volatility, US (VIX)	20.2	21.2	22.5	(levels)
CDSs, Eur (iTRAXX)†	94.2	+5.5	+86.0	+96.2
CDSs, N Am (CDX)†	139.1	+0.4	+58.8	+58.8
Carbon trading (EU ETS) €	22.7	−8.3	+2.1	+7.7

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

Inflation expectations

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Expected inflation rates are on the rise across the world, according to the IMF's recent update of its twice-yearly Global Financial Stability Report. Energy and commodity prices have increased inflationary pressure, particularly in emerging economies. Expected inflation in emerging markets has risen by almost 150 basis points (hundredths of a percentage point) since the start of the year, although it is still below its peaks of 2002 and 2004. Investors fear that the spike in oil and food prices will lead to permanently higher inflation. In mature markets, too, inflation expectations have jumped. They had been broadly stable in a range of 2-2.4% for six years or so, but have recently breached the top of that band.